The Economist

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How bad is Britain's economy?

Pepsi without the fat

Israel v the world

Sarkozy clobbered

Shining a light on shadow banking

Now what?


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to take part in "a severe contest between intelligence, which presses forward, and an unworthy, timid ignorance obstructing our progress."

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Principal commercial offices:
25 St James's Street, London SW1A 1HG
Tel: 020 7830 7000 Fax: 020 7839 2968/9

6 rue Paul Baudry, 75008 Paris, France
Tel: +33 153 936 600 Fax: +33 153 936 603

111 West 57th Street, New York NY10019
Tel 1 212 541 0500 Fax 1 212 541 9378

60/F Central Plaza
18 Harbour Road, Wanchai, Hong Kong
Tel 852 2585 3888 Fax 852 2802 7638

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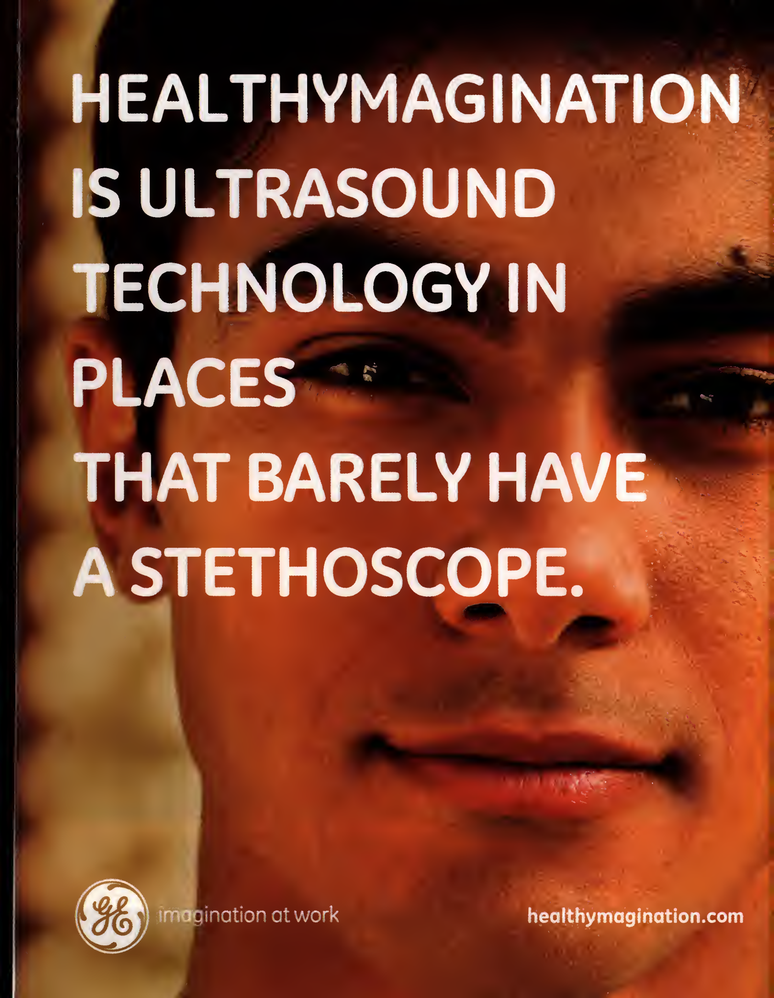
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Politics

After a year of bitter debate in Congress, and a vote to approve a bill by a razor-thin margin in the House of Representatives, Barack Obama finally got to sign a **health-care reform act** into law. Lauded as the most significant piece of social legislation in America since the 1960s, the act ensures near-universal health-insurance coverage and bans insurers from denying treatment to people with pre-existing conditions. Republicans were furious at the manner in which the bill was passed. John McCain said that Democrats had "poisoned the well" and they could expect "no co-operation for the rest of the year" from his party.

The biggest demonstration in a while in support of **immigration reform** and for millions of undocumented workers to be given legal status took place in Washington on the same day that the House voted on health care. But in Arizona a bill advanced in the legislature that would allow police to arrest illegal immigrants for "trespassing" in the state.

A definite chill in the air

Israel's prime minister, Binyamin Netanyahu, had a rough encounter with Barack Obama at the White House. The president is said to be trying to squeeze Mr Netanyahu into making concessions, such as freezing the building of Jewish homes in Israeli-annexed East Jerusalem, which **Palestinians** see as their future capital.

Israel faced a further setback when Britain's foreign secretary denounced its secret service for **forging passports** in the names of 12 British citizens as part of an operation in which an official of Hamas, the Palestinian group, was assassinated in January in Dubai.

Saudi security forces said they had arrested 113 people suspected of being members of al-Qaeda cells. Half of them were Saudis; most of the rest were Yemeni.

Sudan's president, Omar al-Bashir, refused to postpone elections set for April 11th, despite fears that the country is not ready and that the poll could be chaotic. After the Carter Centre, an independent American monitoring group, suggested a "minor delay in polling for operational reasons", Mr Bashir said "we will cut off their fingers and crush them under our shoes."

Nigeria's acting president, Goodluck Jonathan, tapped 33 nominees for a new cabinet, including only nine from the previous cabinet of Umaru Yar'Adua, who has yet to be seen in public since returning to Nigeria in February after months of hospital treatment in Saudi Arabia.

Help is on the way?

Speculation mounted ahead of a summit of European Union leaders that **Greece** would be offered some sort of financial rescue package. Significant involvement by the IMF looked likely, which would mark a victory for the German chancellor, Angela Merkel, who has resisted direct offers of EU aid.

The Labour government in **Britain** delivered its final budget before an election, which will probably take place on May 6th. Alistair Darling, the chancellor of the exchequer, offered a ragbag of measures that offered various economic sweeteners but made little serious attempt to cut Britain's large budget deficit.

Turkey's ruling Justice and Development party unveiled proposals for constitutional reform, aimed largely at the country's military and judiciary. Critics said the measures threatened judicial independence and Turkey's secular tradition. The government said change was needed to prepare the country for EU accession.

Nicolas Sarkozy reshuffled his cabinet following his UMP party's heavy defeat in **France's** regional elections. Dominique de Villepin, a former prime minister and a persistent thorn in Mr Sarkozy's side, announced plans to launch a rival right-wing party.

Partners against the Taliban

America and **Pakistan** began a week-long "strategic dialogue" in Washington, attended on the Pakistani side by the foreign minister, army chief and head of the military intelligence service. Opening the talks, Hillary Clinton, America's secretary of state, acknowledged past misunderstandings and disagreements but said this was "the start of something new".

Thousands of **Nepalis** attended the funeral in Kathmandu of Girija Prasad Koirala, who died at the age of 86. After the end of absolute monarchy, Mr Koirala in 1991 became Nepal's prime minister, a post he was to fill on four occasions.

Afghanistan's president, Hamid Karzai, visited **China**, and signed agreements on trade and economic co-operation. China is already developing one of the world's largest copper mines in Afghanistan.

Sri Lanka refused to issue a visa to Akon, a Senegalese-American singer, after popular protests sparked by one of his videos, in which women in swimwear dance in front of a statue of the Buddha.

A joint plan

American and Mexican officials announced a new initiative to fight **drug-traffickers**, involving closer intelligence co-operation and more American help with police training. The announcement came during a visit to Mexico City by Hillary Clinton and other senior American officials.

The **Inter-American Development Bank** secured approval from its shareholders for an increase of $70 billion in its capital to allow it to maintain its annual lending at about $12 billion, double the level before the world financial crisis. The bank also agreed to forgive $480m owed to it by Haiti.

An opposition politician was detained in **Venezuela** on charges of conspiracy and spreading false information after he accused the government of ties to Colombia's FARC guerrillas and to drug-traffickers. Oswaldo Álvarez, a state governor in the 1990s, is one of several opposition leaders to be jailed or driven into exile by Hugo Chávez's leftist government.

The rate at which the **world's forests** are disappearing has slowed over the past decade but it remains troubling, according to the Food and Agriculture Organisation, a UN agency. Planting efforts in China, India and the United States helped to offset decreases in South America and Africa. Despite the improvement, the yearly net loss of forest over the past decade amounted to an area the size of Costa Rica.

Business

British Airways said that the first in a series of strikes by cabin crew had cost it a less-than-expected £21m ($31m) over three days and that three-fifths of staff had turned up for work. The employees' union disagreed with the figures. The airline cancelled a large chunk of its flights because of the strike, and warned travellers of more disruption ahead of a second walkout planned for just before the start of the busy Easter holiday.

EasyJet named Carolyn McCall as its new chief executive. The British low-cost airline praised Ms McCall's "proven track record" as boss of Guardian Media Group, where she oversaw a restructuring of its titles, which include the *Guardian*.

The World Trade Organisation produced its final report into America's complaint alleging that **Airbus** received illegal subsidies in Europe. The report was not made public. Although **Boeing**, its rival, declared victory, Airbus said that 70% of America's claims had been rejected. The WTO is expected to rule this summer on a countersuit brought by Europe against America. The dispute is likely to drag on for several years.

Dubai said it would provide $9.5 billion in fresh funds to help recapitalise **Dubai World**, the emirate's troubled conglomerate, and its Nakheel property unit. It will also convert debt claims worth $10.1 billion into equity. Under the restructuring proposal creditors will get their money back but after a delay.

Waiting for Beijing's response

After January's row about a cyber-attack from inside China, **Google** made good on its promise to stop censoring its Chinese website and abruptly redirected Chinese users to its servers in Hong Kong, which was granted free-speech protections when China took control of the colony from Britain in 1997. But there were reports that some Google searches were being filtered.

At the start of their trial in China four **Rio Tinto** executives involved in negotiating iron-ore prices with steelmakers made a surprise admission that they had accepted bribes. The four, one of whom is Australian, have been held since July. Their court appearance was swift, with testimony related to "industrial secrets" held behind closed doors.

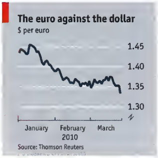
Britain's Financial Services Authority conducted raids on several firms in the City of London in its biggest investigation yet into **insider trading**. Seven people were arrested.

A familiar face

Jon Corzine was appointed chief executive of MF Global, a futures brokerage, marking a return to Wall Street for the former governor of New Jersey. Mr Corzine headed Goldman Sachs in the 1990s, eventually taking it public.

A federal appeals court ruled that the **Federal Reserve** must release documents that show which banks received aid through emergency short-term lending programmes. Bloomberg News and Fox News brought separate cases against the Fed after their attempts to obtain the details were rebuffed. The central bank argued that such information could harm a bank if it was disclosed that it had turned to the lender of last resort.

Kabel Deutschland made its closely watched stockmarket debut in Europe's biggest IPO this year. The German cable-TV operator raised €760m ($1 billion) for its owner, an American private-equity firm. Kabel's share price finished slightly up on the offer price of €22, which was set at the low end of an initial price range.



The **euro** came under more pressure after Fitch, a credit-ratings agency, downgraded its assessment of Portugal's debt. Meanwhile, **Greece** got a little bit of good news as the European Central Bank signalled that it would keep its collateral standards relaxed beyond 2010, making Greek bonds less unattractive.

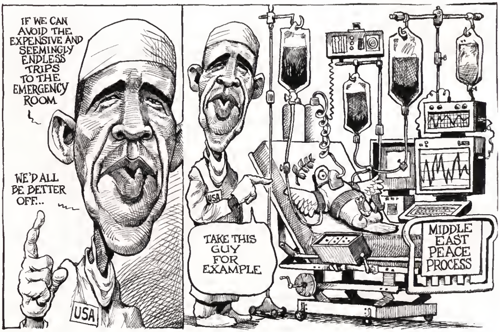
As sales of **new homes in America** fell to a new low in February, partly because of a glut of cheap housing from foreclosures, Bank of America promised to ease the terms of mortgages for those who owe significantly more than their properties are worth. As with other banks, BofA is under pressure from state and federal government to do more to alleviate the housing crisis.

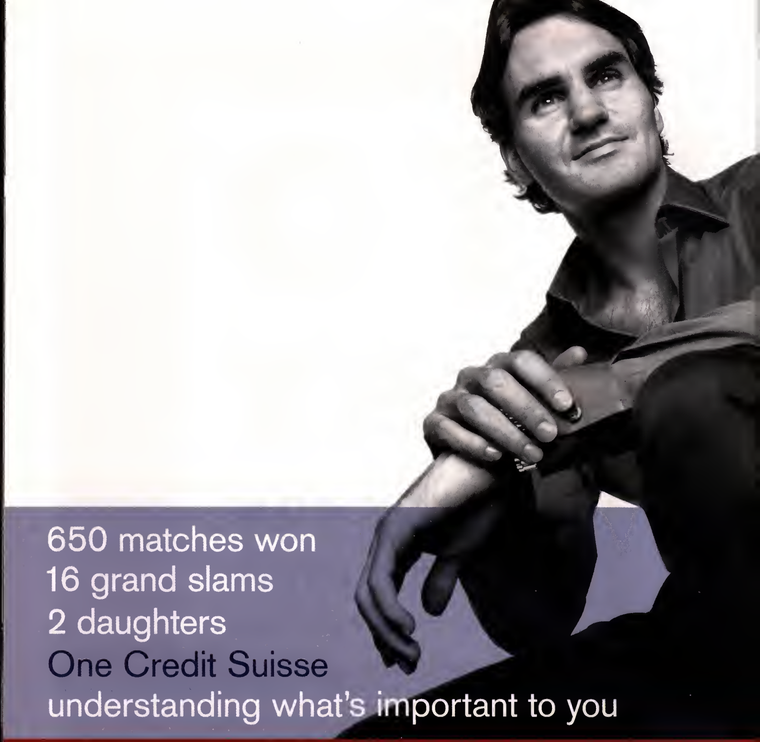
Bertelsmann posted its first yearly net loss in three decades. Along with others in the industry the German media conglomerate, Europe's biggest, suffered from a sharp fall in advertising revenue, though it expects to return to growth this year by increasing its activities in digital media.

Smile

A company founded by former engineers at **Polaroid** started selling new instant film for the cameras. Production ended two years ago, but an estimated 300m Polaroids are still functional and traded on websites such as eBay.

Other economic data and news can be found on pages 109-110

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16 grand slams
2 daughters
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understanding what's important to you

Now what?

Barack Obama needs to use a bruising victory to unleash the promise of his presidency

LAST November Henry Kissinger compared Barack Obama to a chess grandmaster who had played his opening in six simultaneous matches, but hadn't completed a single game. Now the president has won the first of those matches with an audacious checkmate snatched from a seemingly hopeless position. But the rest of the chessboards are still gridlocked.

The health-care victory this week was a huge achievement for Mr Obama (see page 31). After the Democrats in January suddenly lost their filibuster-proof majority in the Senate many, reputedly including his own chief of staff, urged him to play for a draw and settle for a much more modest bill than the 2,400-page behemoth that he signed into law on March 23rd. Instead, the president buckled down: he dumped the (more expensive) House version of the bill, concentrated on the Senate version and criss-crossed the country, making powerful speeches and twisting arms. In short, he took charge, and started doing all the things he ought to have been doing a lot earlier.

His reward, however, is merely the right to continue playing. Had health reform failed after Mr Obama had invested so much of his personal authority in it, his presidency would have been crippled; and a president who is weak at home tends to be perceived as weak abroad as well. Success thus gives Mr Obama a chance to get his presidency back on track, but hardly guarantees it. That depends on him learning from his mistakes and not exaggerating the extent of his success.

A polarising moment

Health care itself is a good example. Universal health coverage has been a goal of Democrats for decades, so Mr Obama's achieving something pretty near to it has perked up morale in his own party. But he has done a rotten job of selling it to everybody else. Most polls show more Americans oppose Obamacare than approve of it, though that may be changing a little. The signs still point towards his party being kicked hard in the mid-term elections; and the Republicans, not one of whom voted for the bill, say that they will repeal it if they can.

Conservative anger was predictable—and may well backfire. But this is a much worse bill than it might have been. This newspaper supported the final version of Obamacare, but only because we have long maintained that a country as rich as America should provide decent health coverage to all its citizens. Because the bill does almost nothing to control costs, it was a huge missed opportunity. American business, which anyhow feels unloved by this White House, will suffer the consequences (see page 74).

That is why Mr Obama now needs to produce a credible plan to tackle America's vast budget deficit. The national public debt is predicted almost to double in the next decade. Beefing up the woefully weak cost-control mechanisms in the health bill will help (and might impress independent voters). But in the end, bringing America's budget under control requires radical reform to all entitlements. Sadly Mr Obama has repeatedly failed to sketch out how he might go about that.

In theory, budget-cutting offers more room than health care did to lure in those obstructive Republicans: fiscal responsibility is supposedly dear to the hearts of the political right. The hitch is that they show few signs of wanting to help out. They have the excuse that Mr Obama initially did far too little to woo moderate Republicans on health care, handing the project over to leftish Democrats in Congress. But conservatives can claim Obama is hellbent on increasing the power of the government over the economy. By passing a huge stimulus package and then "socialising" an industry that accounts for one-sixth of GDP, Mr Obama, they say, has dragged America further leftward than any president since FDR.

That is unfair. Stimulus was needed. And if the tea-party crowd examined the free-market paradise they think existed before Mr Obama signed the bill, they would find that their government already spent more per citizen on health than most OECD countries do. But, as with the appearance of being anti-business, Mr Obama needs to squash his apparent addiction to big government quickly. There would be no better way than spelling out where he is going to take a hatchet to government spending; but he may also have to revise other costly schemes. His proposed climate-change bill, whose chances of becoming law before the mid-terms look slim, would be much improved if boondoggles were removed from it. Another apparently lost cause, immigration reform, is unpopular with conservatives, but is supported by many businesspeople. The re-regulation of Wall Street is harder for the Republicans to oppose. But in each case the president needs to show more determination and leadership than he has thus far.

Abroad, too, there are chess games in need of bolder gambits. As with health care last year, there has been a lot of verbiage and not much steel. In foreign capitals Mr Obama was starting to be seen as a feeble, perhaps even a one-term, president. China humiliated him by sending a junior minister to lecture him at Copenhagen. Russia's prime minister, Vladimir Putin, recently treated Hillary Clinton to a show of indifference. Israel's Binyamin Netanyahu has spent much of the past month cocking a snook at the White House. Now Mr Obama looks more like a winner, he should act like one.

Second life

It is three months since a deadline for Iran to resolve its nuclear proliferation issues expired; where are the tougher sanctions Mr Obama threatened? If health care showed the virtues of a president getting involved, then so too can the Middle East peace process. A start seemed to be made this week (see page 51) but it needs to be followed through. A stronger president would make much clearer to the Chinese that he will not give in to Sinophobic protectionist pressures from Congress, but he won't take instructions about talking to the Dalai Lama either.

Second chances are rare in politics. Mr Obama now has one. Does he want to be remembered as a president who eventually drove through health care but achieved little else? Or will this week mark a turning-point where this enigmatic man became a much more determined, effective president? ■

The British economy

Out of the ruins

Growth will be sluggish. Yet, as a crucial election looms, Britain still has a lot going for it

IT WAS only three years ago, but it feels as though aeons have passed. Back then, the British economy was the strongest in Europe. Open and competitive markets made Britain the posterchild for globalisation in the rich world. Central-bank independence and (supposedly) prudent budgetary management helped produce a vintage period of steady and rapid expansion. British workers were admirably reluctant to strike; British chancellors tiresomely wont to lecture finance ministers in mainland Europe about their superior policies. And British Airways was the world's favourite airline.

Now, with Britain hit harder than either America or the euro area, the nation's self-confidence is as shaky as its credit rating. Instead of preaching to the neighbours, it is the target of European gibes about the consequences of (allegedly) untrammelled liberalisation. The dire state of the economy (see pages 27-29) is the biggest issue on the minds of disgruntled voters in the run-up to the election expected to be held on May 6th. And many BA planes are likely to be grounded again this weekend by another round of strikes.

Yet Britain is not doomed to slink along the bottom of the European league. Its vulnerability to the crisis sprang from its overextended banks, its overindebted private sector and its overweight public sector. The first two of those imbalances are starting to right themselves. The third, for which Gordon Brown is largely responsible, will probably fall to his successor to correct, since the electorate seems minded to turf him out. So long as the next government tackles the problem courageously, Britain's prospects do not look too bad; for the openness and flexibility first fostered by Margaret Thatcher should allow the economy to regain some of its former strength. Growth may be more sluggish than before the crisis—but Britain should still be friskier than its less open neighbours.

First the bad news...

The figures right now look dire. Between early 2008 and the autumn of 2009, GDP shrank by 6.2%. The recession lasted six quarters, longer than in any other G7 economy. Thanks to Chancellor Brown's profligacy and overoptimism in the good years, government borrowing as a share of GDP is forecast by the IMF to be the highest in the entire G20 in 2010. According to the OECD, government spending as a share of GDP rose from 44% in 2006 to 52% in 2009—compared with 48% in supposedly statist Germany. Sterling has lost around a quarter of its trade-weighted value since the middle of 2007. A wave of industrial unrest has not just grounded aeroplanes but has also closed job centres and threatens to halt trains. Once again, the phrase "sick man of Europe" is trotted out.

But the prevailing mood has swung way too far towards pessimism. The budget deficit as a share of GDP may be on a par with Greece's, but Britain's public debt started much lower, at less than 50% of national output in 2007, compared with over 100% in Greece. Britain has always paid its debts; investors don't yet doubt the ability of a British government to get a fiscal grip after the election; and Britons tend to pay their taxes.

Despite the reverses of the past couple of years, the British economy retains important strengths, not least its openness to trade, capital flows and, more recently, migration. There is much talk of rebalancing the economy, of finding new sources of growth now that financial services and the housing market have taken a hit. Yet Britain's economy is already surprisingly varied. It is still the world's sixth-biggest manufacturer. The outlook for financial services may have darkened but London's streets are no less thronged with lawyers, management consultants, accountants and ubiquitous marketing types. Cultural output is strong, with films and video games and edgy fashion pouring forth. Foreigners still want to buy British businesses—and Britain usually does well by it (see page 75).

...and then the slightly better

Delivering his pre-election budget on March 24th (see page 63), the chancellor, Alistair Darling, said he expected growth to accelerate from 1.25% this year to 3.25% next year, then to 3.5% over subsequent years. That smacks of wishful thinking. Britain's banks are reluctant to lend. Consumers owe too much and will have to pay more in taxes whoever wins power in May. The economy has long-standing weaknesses, including congested transport, unreformed schools and patchy skills.

Nevertheless, the prospects for growth look reasonable. Britain's record on improving productivity before the crunch was better than its neighbours'. Flexible labour markets have helped restrain wages, so unemployment has not risen nearly as much during the recession as was once feared. Although unions can still damage companies and disrupt public services, they are comparatively small and weak. And, whereas the weaker members of the euro zone are shackled to the stronger countries, Britain has been able to regain competitiveness by allowing its currency to fall. Growth will probably settle down at somewhere between 2% and 2.5%—well below its rate during the long boom, but not that bad historically.

That, however, depends on the next government doing the right things. In his response to Mr Darling, David Cameron, the leader of the opposition Conservative Party, pointed out that the government had turned the £6 billion deficit it inherited in 1997 into one of £167 billion ($249 billion). The most urgent task for the next government is to start to shrink that figure. Reducing spending too deeply and too swiftly, or raising taxes too fast, would risk tipping an already fragile economy into a deeper hole; but deeper cuts will be needed than the politicians are currently admitting to.

Reducing the deficit is only one reason to cut government spending. The other, bigger, reason is that the state needs to shrink. The numbers of government employees are swelling; the regulations they design go on tying up business; the tax burden is getting heavier. Many of these dismal trends are Mr Brown's fault. What the country desperately needs in the election campaign is a sensible debate about how to reverse them. But nobody—least of all Britons—should underestimate the advantages of an open economy in an intertwined world. ■

Iraq's elections

Give everyone a voice

Stop bickering, find a government of all the people fast, and get the neighbours to help

WITH nearly all the votes counted, Iraq's election has been a success, as far as it goes. Most observers reckon that Iraqis freely expressed their preferences, and more accurately than they did in 2005. This time they voted for candidates as well as faceless party lists. The large Sunni Arab minority, which ran the show under Saddam Hussein, turned out in big numbers, whereas last time most of its people sourly abstained. This does not vindicate the American invasion, which unleashed chaos and strife. But it does give Iraq a chance to entrench one of the few genuine Arab democracies—as long as its competing leaders put country before personal pride.

That looks far from certain. The two main contenders to become the next prime minister, Nuri al-Maliki, the incumbent, and Iyad Allawi, one of his post-Saddam predecessors, are neck-and-neck as the final votes are tallied. As the count has favoured first one and then the other, each man has been crying foul whenever he has lagged behind. The electoral commission has rightly rejected calls for a total recount but should allow limited ones in particular localities if there is plain evidence of wrongdoing. It is vital that whichever candidate is adjudged the loser should accept defeat with good grace.

And they should get a move on. Last time it took six months to form a government, as the country spun into the bloodiest phase of a civil war. Mr Maliki will stay in charge as the process gets under way. But democracy delayed is democracy denied, and a dangerous sense of drift may grow. It is vital, too, that whoever cobbles together a coalition ensures that the Sunni Arabs have a strong voice, otherwise alienation and violence could resume. It would be helpful if Mr Allawi, a secular Shia who has the widest cross-sectarian representation that includes substantial Sunni support, were part of a government, whether or not he leads it. Once again Shia slum-dwellers in Baghdad and the south voted in numbers for Muqtada al-Sadr, a populist cleric. Whether or not he joins a ruling coalition (see page 52), his powerful and often thuggish militia must be disarmed and prevented from creating a state within a state, as Hizbullah has done in Lebanon.

Outsiders must stop stirring the pot

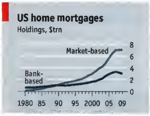
Neighbouring governments this time must also do more to dampen sectarian and ethnic tensions. They are bound to promote the cause of Iraqis likely to be most friendly towards them, but they should resist backing candidates who stir sectarian rivalries as a means to power. Saudi Arabia has yet to open an embassy in Baghdad, which has been taken to mean that it deems Iraq's new Shia-led order to be illegitimate. Instead the Saudis should press Iraq's Sunnis to play a full part in rebuilding the state. Syria, if it wants to re-engage with the West, could do more to stop jihadists seeping across the border. Turkey has sensibly begun to accept the autonomy of Iraq's Kurds, who are likely to be influential in coalition-building. It is also time for Iraq and Kuwait to sort out their differences over borders and debts. And it is to be hoped that Iran too will work with a government in Baghdad that will not bow to its co-religionists in Tehran or seek to impose a Shia theocracy. Before succumbing to the temptation to meddle, countries should reflect that it is better to have a shared interest in a successful country than to dominate a failed one.

Most of all, a new Iraqi government, balanced in sect and ethnicity, should be able to dispense with the services of its American mentor and military minder, though an emergency residual force may well stay behind for a while yet—with the say-so of a sovereign Iraq. A stable Iraq would be good for the entire region. It has at least a chance of emerging. ■

Financial regulation

Shine a light

The parallel "shadow" banking system needs fixing: that should mean painful choices for money-market funds



IF THEY were to film "It's a Wonderful Life" today, the hero would probably not be a banker—and not just because of the optimistic title. The shape of finance has changed radically in the past few decades. For every traditional bank clerk there are several sorts of financial intermediators. The character of George Bailey would today be as likely to manage a money-market fund as take in humble bank deposits. Or he might work at Fannie Mae and Freddie Mac, America's housing-finance giants, buying home loans from banks and packaging them into mortgage-backed securities.

This "shadow" banking system is huge, particularly in America—too big for the banks to be able to replace it. In the summer of 2007 assets funded through the capital markets were larger than those held by America's banks. Only one-third of the country's home mortgages were on banks' balance-sheets. The bank bail-outs hog attention, but many of the government's crisis measures were designed to prop up the shadow system. Even so, many bits of it, especially private mortgage-backed securities, remain moribund (see page 79).

That is a bad thing. The intellectual case for securitisation, the process of pooling lots of different loans and selling the cashflows to investors, remains strong. Done properly, it ▸▸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should enable banks and investors to diversify their exposures. In Europe, where bank lending is more important, it offers a useful, alternative source of financing. But the shadow system has to become far more stable. Great chunks of the crisis happened outside the banks. The rot started in the market for securitised subprime mortgages. Bear Stearns and Lehman Brothers were non-banks that were crippled by a silent run among panicky overnight "repo" lenders, many of them money-market funds uncertain about the quality of securitised collateral they were holding. Mass redemptions from these funds after Lehman's failure froze short-term funding for big firms.

Towards a penumbral banking system

So far the reformers of finance have neglected the shadow system. Some changes are on the way—new liquidity rules for money-market funds, for instance. But uncertainty about the long-term prospects of Fannie and Freddie has been a brake on the revival of securitisation. Congress started hearings on their future this week, but the White House has yet to put forward detailed thoughts of its own. Fiddlier issues require more clarity, too. Investors want assurance that securitised assets will be ring-fenced from claims if a lender fails, for instance.

So more attention is needed. But what should be done? Two things stand out. The first is the need to project some light into the shadows. The pre-crisis securitisation markets were deeply murky. Efforts to get banks to retain more of the risk associated with securitised loans are well-intentioned, but the danger is that investors will regard this as a comfort blanket (as they previously saw gold-plated credit ratings) and skimp on due diligence. Investors need to have up-to-date information on the quality of the loans inside securities: central banks can help by mandating disclosure requirements for collateral that they accept at the discount window. And regulators need better data on obscure areas like triparty repo and stock lending.

The other imperative is to make sure that the bits of the shadow system that act just like banks are regulated accordingly. That shift in thinking has already happened for investment banks, but needs to go further. Money-market funds are an obvious example. Investors in these funds expect to get their money back on demand, just like depositors in a bank. The post-Lehman run started after one fund "broke the buck"; it stopped when the government said it would guarantee investors against losses. So these funds should be forced to make a choice: keep the commitment to pay up and set aside capital and insurance funds (like banks have to do); or drop the commitment and put the burden of losses on investors. ■

France's beleaguered president

Sarko under the cosh

An erratic president needs a credible challenger: time to import a heavyweight bruiser from Washington

NICOLAS SARKOZY ought to be invincible. The president dominates France's government, over which his prime minister, François Fillon, sits as a figurehead. He has no credible rivals on the centre-right. He has emasculated the Socialist opposition by co-opting its talent. Though France has suffered in the recession, with one in ten out of work, he can boast that it has so far fared better than any other big west European economy.

Yet on March 21st voters gave Mr Sarkozy a bloody nose. Regional elections count for little in France and turnout was low. But the 54% share of the vote won by the Socialists (and their green allies) was their best result in 30 years. Mr Sarkozy's UMP party took only 35% and just one of the 22 mainland regions (see page 55). The far-right National Front, which Mr Sarkozy defanged in 2007, rebounded to double figures.

Two points emerge from this. The first is that Mr Sarkozy is, for the first time, under attack from his own side. Some say he has been doing too much at once, pushing unpopular reforms too quickly, and not doing enough to keep grumpy voters happy. His limited government reshuffle this week, keeping Mr Fillon in place, suggests that Mr Sarkozy plans to press ahead with his priority of pension reform, notably to raise the retirement age from 60. But his electoral setback will encourage siren voices in the UMP that call for a slowdown in reform.

Mr Sarkozy should press ahead. He was elected in 2007 because he persuaded voters that France needed big reforms. The recession has only strengthened his case. In the euro area, economies deprived of the safety valve of devaluation must make structural reforms to adjust. Most voters have turned against Mr Sarkozy because he has not brought results—and that is largely because he did not stick to his programme.

Hence the importance of the second point: that the Socialists are back from the dead. It would be a mistake to read too much into one result. The Socialists did almost as well in the 2004 regional elections, only to lose the presidential poll three years later. The party lacks a strong challenger to Mr Sarkozy in 2012. But with a majority of voters saying they do not want Mr Sarkozy to run again, the Socialists are newly confident. The party leader, Martine Aubry, has gained stature, so much so that she may fancy her own chances in two years' time.

Send for DSK

Mr Sarkozy can no doubt bank, as ever, on help from party splits and personal rivalries. Ségolène Royal, whom he defeated in 2007, is eager to run again, as is Laurent Fabius, a former prime minister. But there is one person who polls suggest has easily the best chance of beating Mr Sarkozy in 2012: Dominique Strauss-Kahn, managing director of the IMF. Mr Sarkozy is clearly worried. Insiders say this is one reason why he has opposed a bigger role for the IMF in rescue plans for Greece.

From an independent viewpoint, Mr Strauss-Kahn's candidacy would be good for the country. Because Mr Sarkozy has upstaged everybody else in French politics in the past three years, he has been tested by remarkably little informed criticism. Indeed, this helps to explain why his record has been disappointing. A proper debate against a credible rival would allow the French to decide if Mr Sarkozy, once a shoo-in for re-election, should instead be only the second president in the Fifth Republic to be voted out after a single term. ■

Gendercide

SIR – Your investigation into the 100m girls that have been killed, aborted or neglected ("The worldwide war on baby girls", March 6th) basically posited that abortion is wrong if it is done on a mass scale, but is permissible if carried out in controlled numbers. According to this logic, abortion is fine in America and Europe because it is rare and civilised, but it is wrong in China because it is so widespread. I really don't understand your argument.

Abortion is either right or wrong. It can't be right or wrong based on the number of cases and the sanitary conditions under which the procedure is carried out. What is the magic number where abortion stops becoming rare and thus becomes abhorrent? Please let us know, so those who care can get upset when a country passes that milestone.

GARRY GOERS
Indianapolis

SIR – Since *The Economist* believes that abortion is a choice, and you value the ability of individuals to choose, you surely can't be arguing that the poor in the developing world should be denied the choices that you feel the rich in the Western world are entitled to.

FRANCESCO PAGANINI
Baltimore

SIR – Although abortion accounts for a large part of the baby girls missing in China, thousands more are carried to term and then abandoned in fields, under trees and on doorsteps. Some die. Others are taken to one of the many orphanages across China. Some do well, others do not, but they are relegated to the lowest status in China—that of an abandoned child.

JO BOGUE-HOFFMAN
Eugene, Oregon

SIR – What is so astounding about gendercide is that women are compliant in the preference for having sons over daughters. They must be so discouraged by their own low status in society that they seek a sex-selective abortion, permit or commit female infanticide, or neglect to feed and keep healthy daughters. Gender inequality is the moral challenge of the age.

JANE ROBERTS
Co-founder
34 Million Friends
Redlands, California

SIR – Your report on "gendercide" raised serious issues. But what about those baby girls who "left the womb" only to become victims of violence in later life? The numbers can be difficult to tally but they are large. The *Lancet* reported that somewhere between 15% and 70% of women who have had a partner suffered physical or sexual abuse.

Women were specifically singled out for sexual violence in Bosnia and Rwanda, and continue to be targeted in the Democratic Republic of Congo. Women now represent the majority of people infected with HIV, accounting for up to 2m new infections each year. The ratio of young women to young men infected with HIV in sub-Saharan Africa can be as high as eight to one.

I agree that, "all countries need to raise the value of girls", but we need to raise the value of adult women, too.

DR ARTHUR AMMANN
President
Global Strategies for HIV Prevention
San Rafael, California

Scrambling in the rock shale

SIR – I think your optimism is misplaced regarding new sources of "unconventional gas" ("This changes everything", March 13th). Natural-gas will have a minimal impact on the amount of renewable energy used in our power infrastructure. It could nudge out some coal plants, but that would require a substantial increase in gas production, require large capital costs and take a decade or more to develop.

The pace at which renewable energy is developed will continue to be dictated by a small number of factors: the "site potential" (sun intensity, wind speed, etc), a slow-but-steady optimisation of technology, local demand in terms of megawatts, and how much money the government is willing to spend to encourage its spread. The latter is the only factor we can reasonably expect to change, unless people are magically willing to start paying more for environmentally friendly power.

ALEK DUERKSEN
Blacksburg, Virginia

SIR – You were confused about the function of "proppants", such as sand, used in the process of fracturing gas formations found in shale ("An unconventional glut", March 13th). Rather than stopping the gas from escaping, the proppant is forced into thin cracks in the newly fractured shale to open the cracks wider so that gas can flow more freely.

ROBERT PAGLEE
Moorestown, New Jersey

On the front-line

SIR – I read your article about new technologies that try to neutralise the improvised explosive devices (IEDs) left by insurgents ("Bombs away", March 6th). I served for three years in Iraq. I do not wish to say that such technologies are useless and should not be pursued. Indeed, the developers of v-hull vehicles such as the Buffalo and Husky (not mentioned in your article) should be praised for saving countless lives. However, many of the gee-whiz gadgets that were developed to find IEDs sit unused in the trucks and rucksacks of those who are meant to use them.

It always seemed to me that there were two problems with the developers. One, they were too proud of their work to realise it was of marginal use, and second they continually underestimated the intelligence and creativity of the soldiers and insurgents. The easiest way to predict the location of an IED is to look at a map and think, where would I put one? Choke points, avenues of approach, intersections, areas of routine use; these are the places where IEDs are found (an insurgent wouldn't waste resources building, placing and watching over an IED that had little chance of success).

The army was always supportive and asked for feedback on the technology to find IEDs. If it didn't help, it was scrapped, which only shows it will be sometime before they can replace the sapper in the breach.

CHARLES REI
Former combat engineer in the United States Army
Erlangen, Germany

Home improvement

SIR – It is a shame that fathers are spending less time "showing little Johnny how to hammer in nails" ("Mr Fixit", March 13th). Some of the happiest memories of my childhood were of being taught how to make or fix things with my father and grandfather (no shelves were harmed in the process). Other activities, such as kicking a football, are fun but a child can do that with his peers. Encouraging dexterity in kids and teaching them to take care of their home is vital parenting, rather than posturing, manly or otherwise.

ALEX GREENE
London

A banking conflagration

SIR – Your briefing on what went wrong at Royal Bank of Scotland said that "the bank entered the crisis with a core capital ratio of some 4%, about what is now seen as permissible after a crisis but not before" ("Scots on the rocks", February 27th). This reminded me of the old joke about the building code which recommended a fire-safety inspection at least two weeks before every blaze.

ALEXANDER COTTON
San Francisco ■

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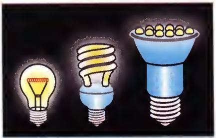
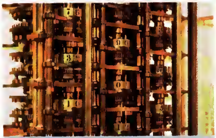
Online highlights



A question of innovation
Do governments inevitably blunder when they get involved in innovation, for example by picking the wrong technology? Or do global problems require the state to support innovation and invest in education and fundamental research? Join the debate
Economist.com/debates



Technobabble
We launch Babbage, a blog on technology. Charles Babbage designed his difference engine, a hand-cranked calculator of polynomial functions, in the 1820s. Modern machines made from his plans do work, but it was never built in his lifetime. We ponder technology and its effects
Economist.com/blogs/babbage

A problem of governance
Anwar Ibrahim, a Malaysian opposition leader, talks about his political standing, his trial for sodomy and the role of Islam in his country. He says that controversies such as the caning of Muslim women for committing adultery are matters of governance not religious intolerance
Economist.com/audiovideo/asia

United States: Get schooled
Our politics bloggers in America put health care to rest and take up education reform
Economist.com/unitedstates

Europe: Crunch time in Brussels
European leaders contemplating Greece's economic woes must consider whether, at last, to offer serious support
Economist.com/europe

Asia: Remembering Girijia Prasad Koirala
A giant of Nepali politics, he saw the kingdom become a republic and handed power peaceably to elected Maoists
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Africa: Fifty years since Sharpeville
A story from the archives on a massacre that further isolated apartheid South Africa
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Business and finance: Social finance
Britain's government has a big new idea for public finance: bonds whose return is linked to the success of social projects
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Business education: The bonus myth
Why bankers might believe less in their colleagues' integrity than in their own—and how that is a problem
Economist.com/business-education

Science: Peek-a-boo
A new method of airport security tests suspects' responses to incriminating stimuli
Economist.com/science

Science: Not easy seeming green
New Zealand's vow of environmental purity is fraying at the edges
Economist.com/science

Culture: Taking the piss
In calling a urinal a "fountain", Marcel Duchamp raised questions about authenticity. Now, ironically, unauthorised "Duchamp urinals" have been found in Italy
Economist.com/culture

Americas: Narcollaboration
Will more collaboration with the United States be enough to stop Mexico's drug war from spiralling out of control?

Daily chart: Slum numbers
In most countries the proportion of the urban population living in slums has dropped since 1990. Zimbabwe and Iraq are sad exceptions
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Applicants should have a **University degree or equivalent (at least at master's level) in a relevant subject**, ideally in economics or accounting. Preference will be given to applicants with a minimum **10 years of practical experience in a senior line or advisory position within a ministry of finance, or a related budgetary institution**, and with relevant experience of PFM reforms in one or more of the PFM fields noted below:

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The closing date for applications for both posts is 5pm on Wednesday 14 April 2010.

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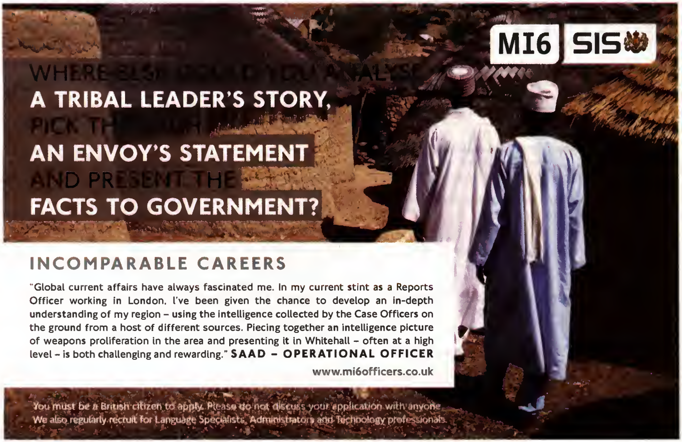

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Economic Affairs Officer, Transport Division (P-4)
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The pain to come

A terrible recession will be followed by a lacklustre recovery, but Britain is no basket-case

FROM the chancellor's brandishing of the red Gladstone box to his speech in the House of Commons, British budgets are events in their own right. But as the drama of the day fades, some turn out to be less about the public finances and more about politics. Alistair Darling's budget on March 24th was first and last a launching-pad for Labour in the general election expected on May 6th.

As Britain prepares to go to the polls, its sick economy is uppermost in voters' minds. With good reason. There are fundamental doubts that it can ever recover fully from a banking crisis and recession that laid Britain lower than many other rich countries. In the short term, the worry is whether a feeble recovery reliant on fiscal and monetary life-support can develop its own driving force. Looking ahead, there are fears that the strong, steady growth rate in the 15 years before the financial crisis is no longer Britain's default mode. And casting a dark shadow over the next parliament are public finances that have veered wildly into deficit and will need to be hauled back harshly from the brink.

Mr Darling sought to soothe. A recovery was under way, but its fragility called for careful nursing, which ruled out an early attack on the deficit this year. To reassure financial markets jittering over the prodigious size of government borrowing, the chancellor showed restraint. He did not dispense altogether with traditional pre-election sweeteners. Mr Darling announced some temporary help for most first-time homebuyers, which will relieve them of stamp duty, a property-purchase tax, and extended some extra payments to pensioners. He also said he would phase in slowly a planned increase in fuel duty. But the overall giveaway will cost a modest £1.4 billion ($2.1 billion) in 2010-11.

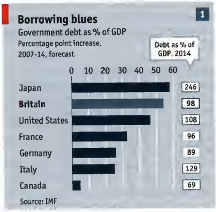
From boom to bust to blight

Mr Darling aimed above all to draw a dividing line between experienced Labour and the neophyte Tories over the central issue of this election: who can be trusted most to steer the economy and restore sound public finances. But Labour's credibility is not what it was. In the past two elections Gordon Brown could and did crow about how well the economy was doing in both historical and international terms. As chancellor he claimed not only to have done away with "boom and bust", but also to have presided over the longest period of sustained growth since 1701. But as prime minister he has broken all the wrong records.

The economy shrank by 5% last year, the biggest fall since the Great Depression. The contraction over the six quarters of the recession was 6.2%. That peak-to-trough decline was less severe than in Japan, Germany and Italy, but the recession lasted longer than in any other G7 economy.

The public finances look even worse. Not only is the budget deficit the highest, as a proportion of GDP, since the second world war, but this year's will be the biggest of any G7 (and even G20) economy, according to the IMF. The build-up in government debt between 2007 and 2014 will be second only to Japan's (see chart 1).

A recovery of sorts began in the fourth quarter of 2009, when GDP grew by 0.3% from its trough in the previous three months. But even this flicker of life may prove to have been snuffed out in the first quarter of this year. Consumers may well have been discouraged when the main rate of VAT, a consumption tax, was restored to 17.5% at the start of 2010 after 13 months at 15% to counter the downturn. Recent disappointing export performance ▸▸



has dimmed hopes that Britain can trade its way out of the quagmire.

As one reverse has followed another, Britain's economic reputation has nose-dived. So has sterling. Its trade-weighted value has fallen by around a quarter since mid-2007, a bigger decline even than after the pound was turfed out of the European exchange-rate mechanism in 1992. For some, Britain now vies with the distressed likes of Greece and Spain for the title of sick man of Europe. Others see disquieting parallels with the 1970s, when Britain's economy certainly deserved that tag. As then, the pound is wobbly, strikes are breaking out again, the public finances are shot to pieces and the election may result in a hung parliament. This has happened only once since the second world war, in February 1974.

There is also more than a passing resemblance to Japan, which never regained its economic stride after its banking crisis of the 1990s. Could Britain now follow suit, given that its financial system came so close to collapse in October 2008? Those inclined to think so find worrying confirmation in a report by McKinsey, a management consultancy, which shows that total indebtedness in the British economy was the highest as a share of GDP among ten advanced countries in 2008, narrowly beating Japan's.

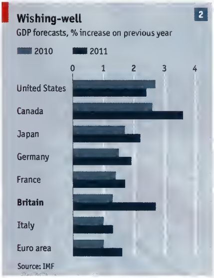
The central charge is that the bloom of economic health in the period of non-stop growth after the recession of the early 1990s turned into the flush of debt intoxication. As the expansion went on, it came to rely too much on consumer and public spending. Current-account deficits were persistent. Now Britain must pay for its sins through a long period in rehab that will make any recovery a pale simulacrum of the real thing.

History unrepeated

There is something in this, but less than the fretters claim. The economy may have been lopsided before the recession, but on nothing like the scale of southern Europe. In 2007 Spain's current-account deficit ran at 10% of GDP; Greece ran one of 14.4%. By comparison, Britain's 2.7% was a mere bagatelle. The fall in the pound has allowed the economy to regain competitiveness in a way not open to the weaker members of the euro area.

As for the resemblances with the 1970s, history is not repeating itself. Inflation has recently flared up, but at 3% in February it is tame; the post-war high, reached in 1975, was 27%. And despite the current industrial unrest, the private-sector unions are no longer the behemoths that Margaret Thatcher squashed in the 1980s.

Of all the unflattering comparisons, the one with Japan is the most salient. There are indeed reasons to expect a financial crisis to scar growth. But Britain is not as deep a debtor as that headline figure from McKinsey suggests. That number is inflated by London's role as a global financial hub where foreign banks cluster to do international business. Adjusting for this, McKinsey reckoned that debt amounted to 380% of GDP in 2008. Although this was the second-highest after Japan (459%), four other countries—Spain, South Korea, Switzerland and France—had debt above 300%. In any case, the consultancy cautioned that total debt was a "crude metric", insufficient to gauge where the real trouble spots are, which in Britain are in borrowing incurred by households and in commercial property.



Even if lamentations about the British economy are overdone, there is no miraculous way out of the mess. The Treasury's projection of 1.25% growth this year seems reasonable. But its prediction that this hesitant trot will break into a gallop of 3.25% in 2011 looks over-optimistic. True, the IMF is forecasting 2.7% (see chart 2). But the latest survey of independent forecasts assembled by the Treasury found that they were expecting, on average, growth of 2% next year.

The recovery is being helped by extraordinarily loose monetary settings. The Bank of England has held the base rate at 0.5% since March 2009 and has injected £200 billion into the economy by purchasing assets with central-bank money. A temporary boost will come as companies stop the fierce destocking that exacerbated the recession. But if the recovery is to take root, it must be able to cope with a gradual withdrawal of emergency monetary support and develop a more sustained impetus from the private sector than a turnaround in the inventory cycle.

That will require new sources of demand. The long expansion was sustained by buoyant private consumption and public spending. Although the pace of consumer spending slackened in the middle of the 2000s, that was against a background of remarkably low real income growth, which meant that consumers had to resort to extra borrowing. As a result the household saving ratio slid from 9.6% of disposable income in 1997 to a 50-year low of 1.5% in 2008. Meanwhile, net trade—exports less imports—kept on detracting from GDP growth.

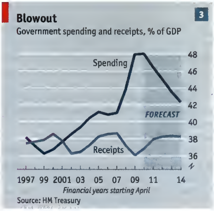
Trade to the fore

Now the economy must be driven by net trade, with private investment pitching in as well. In principle, the fall in the pound has set the stage for this. However, dire figures for exports in January (a fall of 4.4% compared with December) aroused fears that the hoped-for boom in exports will be stillborn. Sceptics say that exporters have not capitalised on the falling pound by cutting their foreign prices.

But exports have at least climbed off their lows of last spring, and adjustment to currency moves takes time. For example, it was not until 1994 that export growth really started to boost the economy after the post-ERM devaluation. The coldest winter in 30 years may have affected January's trade numbers; business surveys are now reporting a big upturn in export orders. That would make sense, since exports are now much more profitable, which should encourage firms to expand overseas.

An associated worry is that Britain has become too reliant on finance. Perhaps manufacturing, which still accounts for around half of all exports, has shrunk to the point where it cannot take advantage of a cheaper pound. But this exaggerates the significance of the financial sector, which even at its peak made up only around 8% of the economy compared with manufacturing's 12%. Britain remains the sixth-biggest manufacturer in the world. And, after a decade of grappling with a high exchange rate (before sterling started to tumble in 2007), industrial firms have become leaner and fitter.

A recovery in private-capital spending should also get under way, not least after the extraordinarily sharp falls that occurred during the recession, with business



investment contracting by 19% last year and housing investment shrinking at around the same rate. There is an urgent need to re-equip the country with new plant, especially to generate power.

But even if the recovery does become entrenched, it is likely to be lacklustre both this year and next. Britain's banks are still trying to mend their battered balance-sheets, which will constrain the supply of credit. This is more of a problem for smaller firms than big companies, which have access to bond and equity markets, but it will act as a brake.

From fool's gold to austerity

The recovery will also be cheerless. The recession, oddly enough, has felt less painful than the steep falls in GDP might have suggested: partly because unemployment has not risen as much as feared, and partly because many households have been shielded by lower interest rates on their borrowing costs. But now the payback comes. Whatever the extent of the country's total debt, British households are certainly the most indebted (relative to disposable income) in the G7. That alone will hamper their ability to spend freely in the years ahead, as the base rate moves up from its current emergency setting of 0.5% and mortgages become more expensive.

As Andrew Haldane, executive director of financial stability at the Bank of England, has pointed out, debt operates like a tax, with higher servicing charges on it reducing disposable income. Making matters worse, an actual tax squeeze is on its way. Labour is planning to raise national-insurance contributions by a percentage point from next year, but that will not be enough. More tax increases will probably be needed.

A feel-bad recovery is better than none at all. But just how fast can the economy expand after the traumas of the past three years?

At the trough of the recession, in the third quarter of 2009, GDP was more than 6% lower than in the first quarter of 2008. If the underlying growth rate of productive capacity had remained the same, this would imply that the economy was operating around 10% below its potential output. With so many spare resources available, the recovery could sprint ahead for several years without inflation taking off.

But financial crises damage the capacity of an economy and can also affect its subsequent growth rate. In a study based on crises in the past 40 years, mainly in emerging economies, Michael Dicks, an economist at Barclays Wealth, has estimated that as much as 7.5% of Britain's potential output has been lost. And he thinks that the sustainable growth rate has fallen to 1.75% a year.

The Treasury thinks Britain will get off more lightly. It has lopped 5% off potential output, but has not changed its view that subsequent trend growth will remain at 2.75%. That is probably too optimistic. The National Institute of Economic and Social Research, a think-tank, reckons that the trend rate is now 2.4%. Bart van Ark, an economist at the Conference Board in America, thinks it could be as low as 2%.

One reason to think that the damage to the economy has been contained is that the labour market has soured less than feared. The fall in output during the downturn has been much worse than in the early 1990s, when GDP sank by 2.5%, but the increase in the jobless rate since early 2008, from 5.2% to 7.8%, has been similar to the rise over the equivalent period in the previous recession. Although unemployment will probably rise further, there should be fewer people shunted out of the labour market who find it hard to get back.

On the other hand, future GDP growth is likely to be slower because there will be less net inward migration. With jobs scarcer and the pound weak, Britain is a less attractive destination and some migrants are returning home. Moreover, both Labour and the Conservatives are committed to curbing future immigration.

The British economy is not alone in expecting a duller future. The euro area looks set for an even weaker recovery, on IMF forecasts at the start of this year. And the IMF envisages Britain outgrowing America next year. The economy has longstanding weaknesses, such as poor skills and a congested transport system. But it retains important strengths, such as its openness to trade and capital, its lead in business services, a strong scientific base and world-leading universities. Michael Porter, a professor at Harvard Business School who has made a career out of studying competitiveness, believes that Britain still remains a "very attractive value proposition".

Britain's political economy is on trial as much as its economy. The government is currently spending four pounds for every three it receives in revenues. This reflects not just the severity of the recession but misjudgments during the good years. It was a mistake to be borrowing at all, let alone over 2% of GDP, in 2006 and 2007 when the economy was strong. Moreover, that deficit would have been even higher but for inflated receipts from ebullient property markets and financial firms.

Mr Darling was able to announce a somewhat improved forecast for this year's borrowing—but only to the extent that terrible is better than horrendous. He is now expecting a deficit of £167 billion in 2009-10, rather than his earlier estimate of £178 billion. But that still leaves it extraordinarily high, at 11.8% of GDP; and it will fall only to 11.1% in 2010-11. That chancellor is expecting the gap to narrow, but by 2014-15, there will still be a shortfall, of 4% (see chart 3 on previous page). Before borrowing blew out so spectacularly, that would have seemed far too much.

Some of the reduction will happen automatically as the economy recovers. However, a stringent programme of fiscal retrenchment will also be necessary. Mr Darling stuck to his guns about deferring the start of this to 2011, on the grounds that the economy is still too weak to start the heavy lifting this year. But the main weakness in the chancellor's plans is that he remains coy about where the spending cuts will be made. Furthermore, his planned tax rises on high earners may well yield less revenue than he hopes. And his predictions for the public finances are acutely vulnerable to setbacks in his forecasts for strong GDP growth from 2011 until 2014.

For the moment, investors and credit-rating agencies are giving Britain the benefit of the doubt. But that will not last beyond the election. Mr Darling's budget is the last breath of a dying government. What will really count is the first one of the next parliament. That budget will have to do what the chancellor failed to do: set out a credible plan for reducing the deficit, grounded in sober rather than wishful forecasts for growth, decide where spending cuts will actually be made, and also—in all probability—announce additional tax increases.

Britain's economy was overhyped before the recession, but the gloom has been overdone since the great fall. If a new government can show that it will get a grip on the public finances, this would help bolster confidence. The country's economic future may be less dazzling than before but that glitter turned out to be fool's gold. After those excesses, a period of private sobriety and public austerity may prove to be no bad thing. ■

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Health reform

Signed, sealed, delivered

WASHINGTON, DC

Barack Obama has transformed health reform from near death to fact. So how will Obamacare change America's health system?

THE Barack Obama who addressed Americans at near midnight on March 21st had every right to gloat. After a year in which his proposals for health reform were savaged by Republicans and leftists alike, and declared dead half a dozen times by everyone, he has somehow managed to get them over the finishing line.

The reform package is made up of two bills. One, a flawed and pork-laden version of health reform passed by the Senate before Christmas, has now been approved by the House; Mr Obama signed this on March 23rd. The other is a "reconciliation" bill meant to fix some of its flaws, and the House also passed this. Because this is a new bill, the Senate has to pass it too. It can do so under special "reconciliation" rules that require only 50 votes, not a filibuster-proof 60. As *The Economist* went to press, it looked set to do so.

What will it mean for America? The short answer is that the reforms will expand coverage dramatically, but at a heavy cost to the taxpayer. They will also do far too little to rein in the underlying drivers of America's roaring health inflation. Analysis by RAND, an independent think-tank, suggests that the reforms will actually increase America's overall health spending—public plus private—by about 2% by 2020, in comparison with a scenario of no reform (see chart on next page). And that rate of spending was already unsustainable at a time when the baby-boomers are starting to retire in large numbers.

The heart of the new reform is a restructuring of America's flawed insurance market. Insurers now face tough new regulations forbidding such practices as dropping people with "pre-existing conditions" (real or trumped up), or putting lifetime caps on coverage.

In return, though, the insurance industry will benefit from a big expansion of the country's private insurance market. Heavily regulated exchanges, or insurance marketplaces, would be set up so that consumers not covered by employer-provided plans today could shop for ones more easily. Insurers would be required to offer plans that meet minimum government requirements for health coverage, and to price them transparently.

Some 32m of the country's 49m or so uninsured (most of those left out of the new scheme are undocumented aliens) would, starting in 2014, be required to take out insurance. The working poor and uninsured earning up to $88,000 a year get subsidies on a sliding scale so that they can afford to buy coverage; the poorest of all will be added to the rolls of Medicaid, a health scheme for the indigent. It is this binding requirement on individuals that exercises conservatives most.

They point to recent studies done by the Cato Institute, a libertarian think-tank, which, they claim, are early warnings of trouble to come. Cato recently examined the impact of introducing health reforms similar to Obamacare in Massachusetts a few years ago. It estimates that the law has not improved people's health, but has led to a "substantial crowdout of private coverage" and to 60% fewer young (and presumably healthy) adults moving to the state. It claims that the "leading estimates understate the law's cost by at least one third." Premiums have also risen.

If coverage is the new law's strong point, cost control is its weakness. That is not to say that most ordinary people will pay more for coverage, as critics of reform noisily insist. True, some of those forced to buy insurance will earn too much to qualify for subsidies, and so will be spending more than they do today—but, in return, they will get insurance plans that offer more generous coverage than current basic plans. What is more, many other Americans may end up with lower premiums.

The vast majority of workers enjoy health insurance today through employer-provided schemes. RAND estimates that by 2019 the employer-provided system will benefit from 6m new (mostly healthy) customers, and that premiums for everyone in that system will drop by 2% versus business-as-usual.

Fine, but what about costs to the federal government and the overall health system? The Congressional Budget Office (CBO), a non-partisan agency, estimates that the new health reforms will cost the federal government some $940 billion over the next decade. Of that, roughly $400 billion will be spent by 2020 on the subsidies and about $500 billion on in- ▸▸

creased spending on Medicaid.

But that underestimates the full cost of this new reform. Elizabeth McGlynn of RAND points out that the huge numbers of newly insured—who now typically skip medical care or simply turn up, in a crisis, in emergency rooms—will soon consume a lot of routine medical services. She thinks this spending will expand the country's health outlays even more than the direct cost to the federal exchequer.

This need not be a waste of money. Spending more on routine care today is sure to save some money in the long run: paying for someone to pop statin pills daily, for example, is much cheaper than treating his eventual heart attack. The snag is that economists disagree on whether and how much this will really save the government or the health system. What is clear, argues Ms McGlynn, is that this new spending will improve the health and probably extend the lives of those many unfortunates currently without insurance.

Paying the piper

So how is the bill going to be paid? The CBO's analysis suggests that the federal deficit will be slashed by well over a trillion dollars over the next two decades by this reform. That suggests this reform effort is fiscally prudent. Not so, howl Republicans. Paul Ryan, a Republican congressman, believes the reforms will prove a "fiscal Frankenstein" (meaning the monster) because the CBO's rules on "scoring" bills have led it to rely on several sleights of hand.

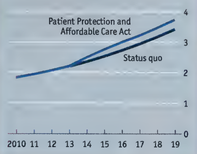
For example, insist critics, a big chunk of the savings is made up of politically implausible cuts in doctors' reimbursements (known as the "doc fix") and in Medicare, the government health scheme for the elderly. Also, some of the income provisions will kick in soon, but the main spending on subsidies will not begin until 2014—skewing the ten-year analysis. The cost to the government of expanding coverage over the ten years from 2014 to 2023 will be $1.6 trillion, not $940 billion.

Such talk infuriates Peter Orszag, the head of the White House's Office of Management and Budget and the administration's most important health expert. He insists all the fuss about ten-year windows obscures three big ways in which this reform will curb costs, by shifting the incentives in the delivery system to reward value and results rather than mere piecework (or "fee for service").

The first big idea that he stresses is the creation of a new agency to spearhead innovation and scale up any of the many pilot schemes contained in the bills that manage to reform delivery or payment systems. It is true that the reform effort began with earnest intent to "bend the cost curve". Alas, explains Mark McClellan of the Brookings Institution, the most meaningful proposals have since been watered down or delayed.

Bending the curve the wrong way

National health spending, $trn, forecast



Source: RAND Corporation

The second lever of change that Mr Orszag says is underappreciated is an excise tax introduced on the most expensive (or "Cadillac") insurance plans. Most economists like this idea, as it is likely to discourage excessive consumption of health care. Unfortunately, because of political pressure from labour unions and other groups, the Cadillac tax has been diluted, and delayed until 2018. Sceptics wonder if a future Congress will really implement this tax when the time comes. Mr Orszag is right that, if implemented, this provision will represent an important lever of cost control. But it's a big "if".

The third and strongest argument Mr Orszag makes is for the potential of an independent payment-advisory board on Medicare spending. Under the new law this group is to make recommendations to Congress on how to reduce the rate of growth in spending per head in Medicare if that expenditure exceeds a target figure.

Sceptics abound. Yes, the approach succeeded when used by the Pentagon to decide which military bases to shut down. But an earlier version of this idea, known as MedPAC, flopped because Congress simply ignored even worthy ideas that proved politically inconvenient. And the new law carves out a ten-year exemption for hospitals—appalling, when one considers that runaway costs and misaligned incentives in hospitals lie at the very heart of the cost problem. But Mr Orszag believes this approach will help in two ways: it insulates tough decisions from politics, and it encourages ongoing reform rather than one-shot heroics. Critics say that is a lot of faith to put in a weakened body.

All this points to the only certain thing about Obamacare: that this is just another episode in the long saga of health reform. Indeed, by adding tens of millions of people to an unreformed and unsustainably expensive health system, this reform makes it all the more urgent to tackle the question of cost.

On that, at least, left and right seem to agree. Paul Krugman, an economics professor at Princeton and a liberal booster of reform, wrote on the eve of the votes: "There is, as always, a tunnel at the end of the tunnel: we'll spend years if not decades fixing this thing." Robert Moffit of the Heritage Foundation, a conservative think-tank opposed to the effort, agrees, albeit in darker terms: "This marks the beginning of the next phase of this hundred years war." ■

Health care and the mid-terms

Miracle or monstrosity?

WASHINGTON, DC

Democrats and Republicans alike are taking a gamble on health reform

IF MOMENTUM is what counts in politics, this has been a wonderful week for Barack Obama. A party that was expecting a battering in November's mid-term elections can now campaign on a promise redeemed. But the knife-edge 219-212 vote in the House of Representatives on March 21st, which could easily have gone wrong for the Democrats, was only the first half of a double gamble, and the outcome of the second will not be known till November. Will voters reward them in the mid-terms for getting their signature legislation through at last? Or, as the Republicans are hoping, will voters punish the Democrats for using underhand tactics to ram through a government takeover that the country cannot afford?

Bill Galston, a former Democratic strategist who is now a senior fellow at the Brookings Institution in Washington, DC, says that having invested so much in health reform, it is better for the Democrats to have passed the legislation than to have laboured mightily and still failed. But he does not think the victory will necessarily save the Democrats from a drubbing in November or even be a net positive. Polls suggest that both the measure itself and the manner of its passing—without a single Republican vote in favour—are broadly unpopular. A Pew survey conducted before the climactic vote in the House on March 21st showed 38% in favour and 48% opposed. A CNN poll published the next day showed 39% in favour and 59% opposed. ▸▸

Our own YouGov poll, however, shows opinion more evenly divided, even though people are nervous about the cost implications (see chart).

Nor can this week's victory be relied on to re-energise the new voters who supported Mr Obama in 2008 but stayed at home in last year's governors' races in Virginia and New Jersey and January's Senate election in Massachusetts. The turnout for the mid-terms is likely to be smaller, older and whiter than it was for the general election of 2008, and Republican voters seem angrier and so more likely to vote. It may prove hard to transfer this week's excitement in the White House to Democratic activists in the field, many of whom hoped for more audacious change, such as a government-run insurance option open to everyone, and are disappointed by a measure that hands millions more customers to the insurance companies and closely resembles the approach the Republicans themselves offered up as an alternative to Hillarycare in 1993.

Republican rage

Despite the resemblance, the Republicans have been swift to denounce the legislation as an abomination and its centrepiece—an obligation on all citizens to buy health insurance on pain of a fine—as a violation of the constitution. Republican attorneys-general (and one Democratic one) are mounting legal challenges and the party leadership promises to "repeal and replace" the law when back in power.

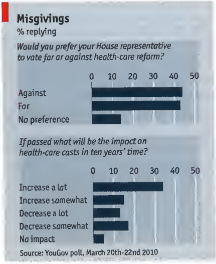
Apart from injuring America, the Republicans say, the Democrats have scored the mother of own goals. "This is the people's House," declaimed John Boehner, the chamber's Republican leader, at the end of Sunday's debate, "and the moment a majority forgets this, it starts writing itself a ticket to minority status." The Republicans claim that using reconciliation to pass amendments in the Senate with a bare majority offends against a tradition of bipartisan lawmaking in far-reaching social legislation. John McCain, 2008's Republican presidential nominee, said the Democrats had "poisoned the well", and that his party would therefore withhold co-operation on legislation from the president for the rest of this year.

By framing the debate in such stark terms, however, the Republicans are taking a gamble of their own. One danger for them is that familiarity will soon start to make the new law look less scary, and the direness of Republican prognostications correspondingly overheated.

In a pep talk before the critical vote Mr Obama told Democrats on the Hill that it would be harder when the bill was law for critics to "mischaracterise" its implications. Voters would notice that "nobody is pulling the plug on granny", that people who liked their insurance policies would be able to keep them, and that there was no "government takeover". Although the reform is to be phased in over several years, the White House is already highlighting potentially popular changes that will kick in this year in good time to influence the mid-terms, such as letting young people remain on parents' policies up to the age of 26 and stopping insurance companies from denying insurance to children on grounds of a pre-existing condition.

On March 23rd a *USA Today*/Gallup poll provided some evidence of attitudes shifting in the president's direction. This found 49% of respondents saying it was a good thing that Congress had passed the bill, against 40% taking the opposite view. About half said they were positive ("enthusiastic" or "pleased") about the reform whereas about four in ten were negative ("disappointed" or "angry"). The largest single group, 48%, described the bill as a good first step that should be followed by further action. So the Republicans' promise to campaign for a wholesale repeal of the bill may well backfire.

It is, after all, a fairly hollow threat. Without a veto-busting two-thirds majority on the Hill, the Republicans cannot hope to repeal the bill until Mr Obama leaves the White House, in 2013 at the earliest. By then, repeal may strike voters as scarier than the new law itself. Departing from the party line, David Frum, a former speechwriter for George Bush junior and now a fellow at the American Enterprise Institute, questioned whether Republicans could really repeal the law once its new protections and entitlements became popular. "Even if Republicans score a 1994-style landslide in November, how many votes could we muster to reopen the 'doughnut hole' and charge seniors more for prescription drugs? How many votes to re-allow insurers to rescind policies when they discover a pre-existing condition? How many votes to banish 25-year-olds from their parents' insurance coverage?"



Time to calm down?

Indeed, Mr Frum concludes that it is in fact his fellow Republicans rather than the Democrats who have scored the own goal. He argues that, for all their talk of bipartisanship, the Republicans decided early on that instead of co-operating with Mr Obama they would turn health reform into his Waterloo, inflicting a crushing defeat like the one they imposed on Mr Clinton in 1994. This time they bet wrong on the outcome. Instead of seizing what might have been a chance to improve Mr Obama's ideas, says Mr Frum, "we followed the most radical voices in the party and the movement, and they led us to abject and irreversible defeat."

Buttressing Mr Frum's argument, there are signs of a backlash against the hateful extremes adopted by some opponents of Mr Obama's bill. The spectacle of Republican congressmen egging on the protesters who shouted vile abuse at black and gay Democrats has done the party no good. A spate of violent attacks on Democratic representatives' offices is not pretty either.

Messrs Galston and Frum are cerebral types working at some remove from the passions feeding the grassroots of their parties. But Mr Galston's warning that health reform may not avert a setback in November, and Mr Frum's that a call for repeal could backfire, are likelier to find their mark as the mid-terms draw nearer and the economy becomes the overwhelming issue again. After their big gains of 2008, and if unemployment is still at a miserable 9% or so, it would be a miracle if the Democrats did not suffer hefty losses, even if this week has put a spring in their step. Yet it could also be riskier by November for Republicans to portray health reform as a monstrous offence against the American way. A lot of Americans may by then have come to like it. ■

Music festivals

The south by south-west sound

AUSTIN

SXSW descends on a once sleepy state capital

ON THE second night of this year's SXSW music festival a man from The Hague, promoting a handful of Dutch bands, vowed that by 2018 his city would be the cultural capital of Europe. It had a head start, he explained, because of all the government there. Far-fetched, maybe. But that approach has worked well enough in Austin, the capital of Texas and host city of the festival in question (pronounced "south by south-west"). Once a sleepy state-government and university town, Austin is now a cultural and technological hub as well. On March 15th a Portfolio.com study pronounced Austin the best city in America for young workers, based on employment rates, rent and the concentration of their peers.

One reason these young people like Austin is the city's lively music scene, which once included Stevie Ray Vaughan and Janis Joplin and now includes fairly popular acts like Shearwater, Spoon and Okkervil River. These acts are among the reasons that Austin bills itself as the live-music capital of the world, and during SXSW it certainly is. Last year, global recession notwithstanding, the official events included over 1,900 bands from 49 countries, and tens of thousands of fans poured in from all over the world. In total, according to an analysis from Greyhill Advisors, the 2009 festival brought some $99m to the Austin economy.

This year's event was even bigger. Seemingly half the city was up all night and ready to go the next morning, after a quick stop for breakfast tacos. Fans broiled in the sun listening to up-and-coming acts like The XX, the Broken Bells, and Sharon Jones and the Dap-Kings. Some old-timers crept back into the spotlight. "I'd stage dive, but I'm far too elderly," said Courtney Love, finishing her first American gig in years.

SXSW is actually a three-part affair. SXSW Interactive, an internet-focused conference, precedes the music, and a film festival runs throughout it. In recent years the interactive bit has been in some ways the most interesting. Twitter, for example, first caught fire at SXSW in 2007. This year the buzz went to services like Gowalla and Foursquare, which combine real-time updates with maps. Austin has been full of moustachioed young men Foursquaring their way around the place.

There is a notion, made famous by Richard Florida, that cities can prosper by put-

To Austin with Love

ting in bicycle lanes and nightlife districts and the rest. These amenities attract the savvy young knowledge workers of the creative class, who in turn attract business. But perhaps the causal connection runs in the other direction. If a city has enough engineers in its tax base, the bike mechanics can scrape together a living alongside them. Either way, Austin has pulled it off. ■

Property prices

Waiting for the other shoe to drop

WASHINGTON, DC

Fears are growing of a second dip in the housing market

IN ITS early days, the Obama administration argued over whether the financial system or the real economy should be the economic priority. Critics disputed the premise. They argued that no lasting recovery would be possible until housing markets were healthier.

Yet the housing-market recovery has almost run out of steam. Sales of new and existing homes have fallen for three consecutive months. As a result inventories have grown, putting downward pressure on home values. According to some measures, prices are dropping again: the Federal Housing Finance Agency reported national declines in December and January.

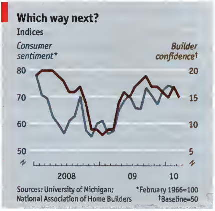
Things looked rosier last autumn. An $8,000 homebuyer tax credit helped stabilise both prices and sales, while Federal Reserve purchases of mortgage-backed securities held down mortgage rates. House values climbed across the country, and existing-house sales hit levels not seen since the end of the boom in early 2007. By September building-industry confidence had more than doubled from January's all-time record low, generating optimism about new employment. Anxious to keep the recovery going, Congress extended the tax-credit programme to the end of April this year. But the magic has not survived the winter.

America's weak labour market deserves much of the blame. Job losses continue to drive loan defaults. Foreclosures declined from January to February, but remained above 300,000 for a 12th consecutive month. Bank sales of foreclosed properties are depressing prices further and dampening the industry's hopes (see chart). The latest data show declines in both builder confidence and new housing starts.

The weather hasn't helped. Fierce winter storms hit house-hunting in January and February. But with prices, sales, construction and builder confidence all losing ground and foreclosures still frequent, there is growing concern that the housing-market stabilisation of 2009 was entirely a product of market interventions, most of which are about to end.

This pessimism may be overdone. With the deadline to take advantage of the housing tax credit looming and with better weather on the way, potential buyers kept indoors by February snow may rush into the market. Construction has been so depressed for so long that a flurry of buying could quickly trim inventories, supporting prices and construction and touching off a virtuous cycle in housing markets. And America's housing correction has been more thorough than those elsewhere, leaving homes much cheaper.

But the window for a turnaround is closing fast. The Federal Reserve's $1.25 trillion programme of buying up mortgage-backed securities ends this month, and mortgage rates are expected to rise thereafter. With budget politics dominating headlines in Washington, another housing-tax-credit extension is unlikely. After April, housing markets will largely be on ▸▸



their own. By autumn payments will be adjusted upwards on a new bulge of mortgages, while interest rates may rise further ahead of expected tightening by the Fed.

Meanwhile Washington's foreclosures policy continues to fail to rise to the magnitude of the problem. The administration's programme to restructure distressed mortgages, intended to help up to 4m households, has produced only 170,000 permanent modifications.

A renewed decline in the housing market is not inevitable, but it is starting to look increasingly likely. And if prices start to drop once again, causing both household wealth and construction employment to fall, while boosting the rate of defaults, the broader economic recovery, which is still fragile, may very well suffer as a result of housing's woes. ■

Detroit's future

Thinking about shrinking

DETROIT

Efforts to "right-size" Detroit are arduous and desperately necessary

ON MARCH 23rd Detroiters packed into a grand auditorium in the city's midtown. Charles Pugh was there, the leader of the city council. Carol Goss was there, head of the Skillman Foundation, a busy local charity. Firemen, reporters and throngs of ordinary Detroiters jammed into the seats. Dave Bing, the mayor, was due to give his first state-of-the-city speech. Detroit was eager to hear his vision.

The city has had a dismal stretch, even by its standards. But harsh realities have produced radical thinking. For the first time, dramatic steps are being discussed seriously, including plans to close dozens of schools, cut services and transform the landscape. The speech was a chance for Mr Bing to chart the way forward.

Mr Bing did describe his vision, but for now it remains hazy. The most urgent tasks are to create jobs, cut crime and clean up a fiscal mess. His long-term plan is less clear. The city, he said, would demolish 3,000 homes this year and 7,000 more by the end of his term. This would be only the first step toward re-imagining Detroit. Already, however, local groups are working on plans for broad change. Their premise was once politically unthinkable: before Detroit can thrive, it must shrink. Mr Bing supports this. But executing it will be difficult.

For years, reviving Detroit meant recreating a bustling metropolis. This has changed, thanks to a string of devastating events. Detroit was ailing before the downturn, but foreclosures have weakened the city's few healthy pockets: Rosedale Park, a lovely neighbourhood in the north-west, now has boarded-up houses beside its pretty brick ones. The collapse of America's carmakers, meanwhile, has helped push unemployment close to 30%. Economic disaster has coincided with political chaos. In 2008 the then-mayor was indicted. Mr Bing, a 66-year-old former basketball star turned businessman, took over last May before winning a full term last November. The budget deficit is now $325m.

All this has prompted two overdue epiphanies. First, Detroit needs to plant the seeds of a new economy. Second, the city can no longer afford itself. In place of the old must come a new, leaner city.

The effort to "right-size" Detroit is concentrated in schools, city government and land use. All should be considered together, but this is not so simple. Detroit's schools have seen most progress. Last year Michigan's governor appointed a temporary manager, Robert Bobb, to take over Detroit's troubled education system. This month Mr Bobb announced a package of bold reforms, including mayoral control and a capital plan that would close 45 schools this year; he is being sued for his pains. Enrolment has dropped by almost half since 2002.

Other efforts to shrink government are moving even more slowly. Mr Bing has long said that he wants to consolidate the city's sprawling departments; the unions are resisting. The most complex question, however, is what to do with Detroit's sprawling landscape. The city's population is half what it was in 1950, but its boundaries contain an area the size of Manhattan, San Francisco and Boston combined. A third of Detroit is vacant, its lots occupied by singed houses, tyres and nomadic plastic bags. Over the years the city, foundations and community groups have poured money into neighbourhoods without a broader strategy. Now there is a growing consensus to shore up viable areas, rather than try to repopulate the worst.

This raises many questions. Which neighbourhoods should be saved? What will happen to residents of declining ones? Detroiters are sceptical of anything foisted on them by outsiders. Who should lead change and gather support for it?

While Mr Bing is distracted by the city's fiscal problems, others have rushed to present their ideas. One local group, the Next Detroit Neighbourhood Initiative, has a new plan to invest in districts such as Rosedale Park. A coalition of community-development organisations is crafting its own plan to support viable neighbourhoods and transform troubled ones into farms or parks. In a delicate exercise, charities are trying to present their agenda without usurping the mayor. The Kresge Foundation, based in Detroit's suburbs, is paying a prominent consultant to advise the mayor's planning department.

But "the mayor really has to lead the work," explains Ms Goss of the Skillman Foundation. Mr Bing, unlike so many of his predecessors, is wonderfully frank. He acknowledges that shrinking Detroit is a painful necessity. The real test, though, is whether he has the tenacity to guide this exhausted city to its next chapter. ■

To everything there is a season

Lexington | From hope to change

Barack Obama has made history. But he can still make mistakes

A BLIND senator asked a question: "Isn't this a teeny weeny bit of socialism?" The year was 1935, the senator was Thomas Gore of Oklahoma (no relation of the former vice-president) and what he disliked was the creation of Social Security (public pensions). Big changes always provoke loud howls, and Barack Obama's health reform is no exception. Mitt Romney, a Republican presidential aspirant, called it "an unconscionable abuse of power". Richard Land, a Southern Baptist leader, said it would "lead to the overwhelming majority of Americans living shorter lives and experiencing more pain and suffering before they die". Jim DeMint, a Republican senator, called it "an insult to our democracy" that "threatens our nation's prosperity and freedom".

Relish it or revile it, everyone agrees that the bill is historic. None of Mr Obama's predecessors managed to make health care universal. Teddy Roosevelt's plan came to naught nearly a century ago. Franklin Roosevelt's attempts in the 1930s and 1940s were frustrated. Harry Truman's grand scheme fizzled, as did Dwight Eisenhower's more modest one. Lyndon Johnson brought health care to the elderly and the poor. Richard Nixon, Jimmy Carter and Bill Clinton all tried to extend it to everyone else, but failed.

How does it compare with the great domestic reforms of the 20th century? One difference is that Obamacare has been a strictly partisan affair. Not a single Republican voted for the final bill. Contrast this with the Civil Rights and Voting Rights Acts of the 1960s. Some 80% of congressional Republicans (and a smaller majority of Democrats) voted to give black Americans equality before the law. In the same decade roughly half of Republicans joined the Democratic majority in voting to create Medicare and Medicaid (public health care for the elderly and the poor, respectively). Bill Clinton's welfare reforms, which chivvied the jobless to find work, were also solidly bipartisan. The American system of checks and balances makes it hard to pass sweeping change without broad consensus. That Mr Obama went for broke despite polls showing a plurality of voters opposed to his plan strikes some as bold; others as rash. Some pundits predict that it will cost his party control of the House of Representatives in November, though one new poll suggests that Mr Obama's success has won him back some support.

Many on the right think Mr Obama is determined to change the relationship between the individual and the state. By adding health care—a sixth of the economy—to the list of services Americans expect from their government, Democrats hope to spread dependency, reckons George Will, a conservative columnist. Benefits, once granted, are tough to take away. Beneficiaries will thank Democrats for their health insurance and recoil from Republicans who might snatch it away. Government will swell, freedom will recede and the great American tradition of self-reliance will wither a little. Ronald Reagan once argued that government medicine is a "foot in the door" for socialism; and Mitch McConnell, now the Republican leader in the Senate, told the *New York Times* recently that Democrats are trying to turn America "into a western European country".

Nonsense, say Democrats. A plan that helps more people buy private insurance is hardly a stepping stone to socialism. The status quo was unacceptable. Americans spend far more on health than people in other rich countries, but die younger. America even spends more public money per head than many rich countries where the government covers everyone. The basic planks of Obamacare—compelling citizens to buy private insurance and subsidising those who cannot afford it—are hardly Marxist.

Nonetheless, the fears of Republicans and tea-partiers are not entirely foolish. America's public finances are a mess, and adding a huge new entitlement will not improve matters. The White House insists that a proposed commission to restrain health inflation will have powerful jaws, and perhaps it will. But entitlements tend to cost more than their creators predict. The payroll tax that funds Medicare is nearly twice what it was originally supposed to be, but the programme is still hurtling towards insolvency. Obamacare will mean higher taxes, and that is in addition to the tax increases that were coming anyway. Neither party likes to admit it, but bringing the deficit down to less threatening levels will require both tax hikes and spending curbs.

A less exceptional America?

For decades not having universal health coverage has been an important (if ugly) aspect of American exceptionalism. So this week is a good time to ponder whether America is becoming less exceptional. Obviously, America is not like France, where the state controls more than half the economy including a phalanx of big firms. But it has moved in that direction. Public spending (federal, state and local), which was 24% of GDP in 1950 and 35% before the current recession, could hit 44% this year. Uncle Sam owns big chunks of General Motors and Chrysler, among other companies. Is the expansion of the state under Mr Obama a temporary response to the economic crisis, or the harbinger of something permanent?

Some Americans would welcome a more European future. In a new book, Steven Hill of the New America Foundation extols the European social contract of higher taxes for better government services. Life in Europe is more secure, he argues, and therefore more agreeable. On the other hand, government incentives gradually shape a culture, and can deform it too. Safety nets, if too generous, make work optional. Tax rates, if too high, punish it. Regulation, if too intrusive, throttles enterprise. America is still the most dynamic nation on earth, but Mr Obama should not take that for granted. ■

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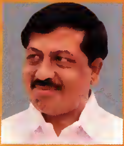

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Mexico, the United States and drug gangs

Turning to the gringos for help

MEXICO CITY

As drug-related violence continues to rise, Mexican and American officials unveil plans for unprecedented security co-operation. But will they work?

LAST March, after Mexican officials took offence at warnings from their American counterparts about security south of the border, Hillary Clinton travelled to Mexico City to repair the diplomatic damage. The secretary of state accepted blame for her country's demand for illegal drugs, recognised its need to control the southward flow of guns and cash, and vowed that the United States would be an equal partner in the "war" against drug gangs and organised crime declared by Mexico's president, Felipe Calderón. Some of those promises have been kept, in a modest way: over the past year, Barack Obama's administration has seized a little bit more drug money, begun to search southbound freight trains, examined its budget for trying to cut drug demand and raised it by 13%, and shared intelligence that led to the finding (and death) of a top drug trafficker.

But the drug "war" in Mexico has intensified, with 6,600 killings last year, up from 5,800 in 2008. This year has started badly. In the border city of Ciudad Juárez, 555 people have already died in 2010, compared with 449 in the first quarter of 2009. The violence is starting to strike innocents. In January 16 teenagers at a party were massacred in Juárez. Two students at Monterrey's Technological Institute were killed in crossfire this month; afterwards the traffickers organised roadblocks of stolen and torched vehicles, causing chaos in the city, Mexico's industrial capital.

In Reynosa the Gulf "cartel" and its former armed wing, the Zetas, concealed their violent split for weeks by threatening local journalists, killing one. Residents were reduced to finding out about the gun battles they heard nearby on Facebook and Twitter. On March 13th the traffickers broke a taboo against taking on the United States. In simultaneous drive-by shootings, gunmen killed a visa worker at the American consulate in Juárez, along with her husband and that of another employee there.

Faced with such a grim panorama, this week Mrs Clinton returned to Mexico City, accompanied by the entire American national-security team. She reiterated many of the same arguments. But this time both sides wanted more than soothing rhetoric.

After three years of throwing some 50,000 troops against the drug gangs, Mr Calderón is now trying to broaden his strategy. In tandem with American officials, his government has announced a new plan to fight organised crime. This will be enacted in pilot programmes in Juárez and Tijuana, the two biggest border cities. It includes customised attempts to dismantle each gang through intelligence; spending on social development in violent areas; and a promise to speed up a glacial effort to overhaul police forces and the courts.

All of this will require far greater teamwork with the United States. American officials say that the new plan calls for more intelligence sharing, with "fusion centres" where American agents are embedded with Mexican analysts. American police will step up training and vetting of their counterparts. To try to prevent security worries clogging cross-border trade, American customs officials may be posted throughout Mexico. "Secure corridors" would be set up where goods could be tracked to the border. Mrs Clinton announced that the Mérida Initiative, a $1.3 billion anti-drug aid effort for Mexico involving hardware and training, will be followed by $331m for social programmes and to strengthen the courts.

In the past this closer American involvement would have prompted Mexican outrage over the violation of its sovereignty. The mood is changing. In the run-up to Mrs Clinton's visit both Mexico's ambassador to the United States and the general in charge of its defence college declared that the country needed international help to win the drug war. "It was unprecedented for a high-level member of the Mexican army to say that," says Denise Dresser, a political scientist at ITAM, a Mexico City university. "But the situation has gotten so bad that you're starting to see a wearing down of that reflexive, historical anti-Americanism."

Yet compared with the $18 billion-39 billion that the drug gangs are officially estimated to send south each year, American aid to Mexico remains small. And only ▸▸

$128m of the money promised under the Mérida Initiative, signed in 2008, has been disbursed.

American officials point to the relative success of Plan Colombia, a much bigger aid programme, in reducing drug-related violence in that country. But Mexico poses some unique difficulties. It is bigger and richer but more decentralised, with weaker police forces and courts. Colombia has let several hundred American military advisers operate in its territory. Some of the training of Mexicans takes place in the United States. Mexican officials refuse to put American agents in operational roles. "That takes a lot of options off the table," says Scott Stewart of Stratfor, an intelligence consultancy. "There's only so much you can do in the classroom instead of out on the streets." And the Obama administration has ruled out seeking a new ban on the sale of assault weapons in American gunshops—the main source of the mobsters' weaponry.

The new strategy looks more promising, but as always success will depend on implementation. Polls suggest that Mexicans' previous support for Mr Calderón's crusade against the drug gangs is wearing thin. In one recent poll only 21% of respondents said that it had made the country safer, whereas half thought it had heightened the danger. Mr Calderón's term ends in 2012, and his successor may not be equally committed to vanquishing organised crime. The new long-term plan will have to show some short-term results. ■

Ecuador and financial crime

The Andean laundry

QUITO

Worries that organised crime is tightening its grip

IT WAS long an island of tranquillity surrounded by countries racked by guerrillas and drug trafficking. But whereas violence has declined in Colombia and Peru, Ecuador has acquired a reputation as a new capital of financial crime. Last month the Financial Action Task Force, an intergovernmental body, declared that Ecuador has not shown "a clear high-level political commitment" to address its "strategic deficiencies" in fighting money laundering and the financing of terrorism. That put it on a list with the likes of North Korea, Iran and Turkmenistan.

Others have reached similar conclusions. Francisco Huerta, an experienced politician who led a government-commissioned investigation into a Colombian raid on a FARC guerrilla camp just inside Ecuador in 2008, said that the country risks becoming a "narco-democracy". Tourists, residents and club owners complain of rampant crime in La Mariscal, Quito's nightlife district where some bouncers are now Russian and many of the customers African and South Asian. Ecuador has become particularly attractive for money launderers because of its combination of weak laws and use of the American dollar as its currency. An American think-tank, the International Assessment and Strategy Centre, reckons that it has become a hub for Russian and Chinese crime syndicates.

The left-wing government of Rafael Correa rejects all of this as factually wrong or ideologically inspired, or both. "There are no Russian or Chinese mafias operating here," insists Miguel Carvajal, the security minister. But he admits that drugs from Peru and Colombia do pass through. In response the army and the police have patrolled more. They seized more than 73 tonnes of drugs (mostly cocaine) last year, more than double the figure for the previous year. Surveillance of the northern border, almost non-existent before the Colombian bombing raid on the FARC camp, has been stepped up. Mr Correa has sharply increased spending on the police.

But much of the extra money has gone on weaponry rather than urgently needed training, says Fredy Rivera, who was in charge of domestic security at the Interior Ministry. He is one of several officials who recently resigned from a ministry in disarray. An American-supported project to eavesdrop on suspected drug traffickers has been beset with technical problems. An organised-crime unit has been idled by a dispute with the United States, which provides the bulk of its funding, over the control of lie detectors.

The criticism coming from the Financial Action Task Force was more especially damaging. The foreign minister, Ricardo Patiño, says the government does not recognise this body's right to "dictate policy". Its recommendations are indeed not binding on governments. But its findings are already making it even harder for local banks and companies to secure foreign loans. That problem began with Mr Correa's default on $3.2 billion in foreign debt in 2008. Ecuadoreans have difficulties using their credit cards overseas.

Ecuador's inclusion on the task force's blacklist seems to be mainly because of its new ties to Iran. The Central Bank has dealings with Iranian banks suspected of financing the country's nuclear programme, despite the objections of the bank's own compliance officer. It has received a $40m deposit from Iran's Central Bank, according to a former central-bank president.

Mr Correa retorted that the government would ignore the task force's findings. But his attorney-general said that it would seek to overturn them. Mr Carvajal says that Ecuador already complies with 60% of the recommendations and that officials are quietly drafting a bill to outlaw the financing of terrorism. Not for the first time, Mr Correa's government seems to be pointing in several directions at once. ■

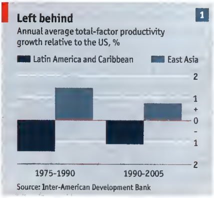
Latin America's unproductive economies

Service break

How public policies have promoted inefficiency

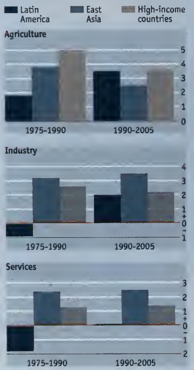
ITS economies may have improved recently, but much of Latin America has performed poorly over the past two generations. The gap in income per head between the region and developed countries has widened since 1960, while many east Asian countries that were poorer have leapfrogged ahead. The root cause has been Latin America's slow—or even negative—growth in productivity, according to a new study by economists at the Inter-American Development Bank*.

Productivity growth—gains in the efficiency with which capital, labour and technology are used in an economy—is the elusive holy grail of economic development. It is true that most Latin American countries have not invested enough, or provided their people with a good enough education (though both these things are ▸▸



The Latino disease 2

Annual average labour productivity growth, %



Source: Inter-American Development Bank

improving). But productivity growth means squeezing more output from the same inputs. And Latin America has been particularly bad at this (see chart 1). Why?

The short answer is that the typical Latin American firm is a small, inefficient service business and may well be operating in the informal economy. Productivity growth tends to be higher in manufacturing and agriculture than in services (chart 2). It also tends to be higher in large firms which benefit from economies of scale. And it is much higher in formal businesses, which can invest in innovation.

However, Latin American manufacturers are also much less productive than they might be. This is partly because clogged, inefficiently run ports, airports and other transport systems make freight costs unduly high—for example, it shockingly costs more to get goods to the United States from most Latin American countries than it does from distant China or Europe.

But 60% of Latin Americans work in service firms. Many of these businesses are held back by lack of credit and by public policies that give them little or no incentive to become bigger or to operate legally. Latin American tax codes are inordinately complicated: it takes an average of 320 hours per year for a firm in the region to file its tax paperwork, compared with 177 hours in rich countries. The IDB found that a disproportionate share of tax is paid by big companies. Simplified tax regimes for small companies have been set up in 13 of the 17 countries the bank studied. Perversely, that encourages them to remain small.

Only one in three Latin American workers is covered by social-security systems financed by payroll taxes. Governments have responded to this inequity by creating non-contributory pensions and other social programmes. As an unintended consequence, that means there is little incentive to leave the informal economy.

But not all is gloomy. In Chile productivity growth since 1960 has outpaced that in the United States. And since 2006 there has been "an upward blip" in productivity growth in the region as a whole, says Carmen Pagés, who co-ordinated the study. This has gone hand in hand with faster economic growth and an expansion of credit. Productivity growth in Brazil has surged recently: after being negative in the late 1990s, it rose to over 2% in 2007 and 2008 according to the Central Bank.

When economists say that productivity growth is the root cause of development they are almost stating a truism. From the late-1970s to the early 2000s Latin America suffered a macroeconomic slump, accompanied by high inflation and the destruction of credit. Political instability—and expropriations of businesses—in some countries also discouraged firms from growing. It is hardly surprising that productivity suffered.

The achievement of economic and financial stability in the past few years has in turn seen productivity growth rise. The IDB's study shows that it could rise faster still, boosting incomes, if the politicians take productivity into account when they draw up tax, social and public-investment policies. And the economic weight of services means it is not enough for the region to talk only about export competitiveness. Productivity begins at home. ■

*The Age of Productivity: Transforming Economies from the Bottom Up, edited by Carmen Pagés, Inter-American Development Bank and Palgrave Macmillan.

Cuba's food shortages

Hungry for change

HAVANA

The timidity of agricultural reform

TWO years ago last month Raúl Castro formally took over as Cuba's president from his convalescent elder brother, Fidel. The switch raised hopes of reforms, especially of the communist country's long dysfunctional agriculture. But change has been glacial. Official figures show that in the first two months of this year deliveries to the capital's food markets were a third less than forecast. Nobody starves, but hard-currency supermarkets go for weeks without basics such as milk and bread.

What has gone wrong? Cuba's state-owned farms are massively inefficient, and rarely provide more than 20% of the country's food needs. Three hurricanes in 2008 made matters worse. Raúl Castro has acknowledged the problem, and introduced some changes. Idle state land has been leased to private farmers. The government has raised the guaranteed prices it pays for produce. Farmers can now legally buy their own basic equipment such as shovels and boots, without having to wait for government handouts

But farmers say that the reforms have been too piecemeal to be effective. In meetings across the country they have called for more. They want to buy their own fertilisers and pesticides, and to control distribution. The government still supplies almost everything, and does it badly. Much of last year's bumper crop of tomatoes rotted because government trucks failed to collect them on time.

Significantly, the state-owned media have reported the farmers' complaints in some detail. They have also announced that 100 of the most inefficient government farms will be closed. Officials are launching a pilot plan to set up market gardens close to cities. And reports from eastern Cuba suggest that food shortages there are less acute than in the capital.

But Raúl continues to move very cautiously. So Cuba will buy much of its food from foreign suppliers. Foreign exchange, never abundant—partly because of the American economic embargo—is again in short supply. The world recession cut Cuba's earnings from nickel and tourism last year. Imports fell last year by almost 40%.

A foreign businessman in Havana says there have been signs of a further squeeze this year. Transfers abroad by foreign businesses have been blocked, or delayed, for months. The Spanish owner of Vima, a food importer which supplied many hotels and state-run restaurants, made the mistake of publicly criticising delays in getting paid. His contracts were promptly revoked. Foreign companies have been warned that the government may stop selling them staples, such as meat and rice, for their staff canteens. "They told us bluntly that their priority is feeding the general population, that the situation is very serious, and that we should make our own arrangements," says a manager of one joint-venture.

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Malaysian politics

Najib v Anwar

KUALA LUMPUR

Even as Anwar Ibrahim faces a legal battle, the opposition he leads suffers other setbacks

TO LOSE one member of parliament during a recess is a reverse. To lose three, along with a senior official, as has happened to Malaysia's opposition, looks like a big lurch backwards. Two years after making historic gains in a general election, the opposition is going through a bit of a wobble. The spate of defections, and the hint of more to come, has cheered the ruling Barisan Nasional (BN) coalition led by the prime minister, Najib Razak. And it has created more headaches for his opponent, a former deputy prime minister, and now opposition leader, Anwar Ibrahim.

Mr Anwar takes the blame for lax discipline in the ranks of his People's Justice Party, known as PKR, which has won support from the government's critics in all of Malaysia's ethnic groups. His colleagues fret that his leadership has drifted as he grapples with the trial and the possibility that he may, once again, be jailed for sodomy, as he was in 1998 after falling out with his mentor, the former prime minister, Mahathir Mohamad. A new sodomy trial, due to resume on March 25th, has been delayed until May 10th and is expected to drag on until August.

Even a short jail sentence would bar Mr Anwar, who is 62, from political office for five years. That would be a serious blow to PKR, and its two coalition partners, an Islamic party and a Chinese-dominated one. Without Mr Anwar's charismatic leadership, some fear that the coalition would fall apart. The loser would be Malaysia's democracy, which, for the first time since independence in 1957, has an opposition that seems capable of winning power.

Speaking in London on March 20th, Mr Anwar insisted there was "not a shred of evidence" for the sodomy accusation, made in 2008 by a former male aide. He said his opponents should focus on fighting him in elections. But he admitted to frustration with some of PKR's 2008 parliamentary candidates. The party had "struggled to convince people to run." Such fair-weather friends have since fallen to the strong-arm tactics and money politicking of BN's dominant United Malays National Organisation (UMNO). Similar tricks were used in March 2009 to poach PKR assemblymen in Perak, an opposition-run state, which flipped back to BN.

UMNO officials retort that Mr Anwar is getting a taste of his own medicine. He vowed to topple BN in parliament in September 2008. The threat of mass defections was taken so seriously that the government hurriedly sent 40 MPs to Taiwan on an agricultural study-tour. Mr Anwar's deadline for defections came and went, leaving the mystery of who might have been prepared to jump ship.

On March 18th a disgruntled ex-PKR legislator, Zahrain Hashim, in a parliamentary speech, identified eight BN members as would-be defectors. For good measure, he said Mr Anwar had claimed to have the backing of Malaysia's army chief and its king to form a government. UMNO hotheads have demanded an investigation into Mr Anwar's conduct.

Although such calls may wither, the sodomy trial will not go away. A PKR official complains that Mr Anwar has not said what will happen if he is convicted. If there is a Plan B, nobody knows it, he grumbles. A likely stand-in is Mr Anwar's wife, Wan Azizah, who ran the party when he was barred previously. A wildcard candidate is Razaleigh Hamzah, a veteran UMNO maverick minister, who featured on Mr Zahrain's list of eight, and publicly admonishes his own party for its corrupt ways. He is at odds with the government over the denial of oil royalties to Kelantan, an opposition-ruled state. But Mr Razaleigh denies any approach by Mr Anwar and says he does not hanker for a government post. "No thank you," he smiles.

PKR has other worries. Party donors have been pressing for contracts from opposition-run state governments, only to be told to compete with other bidders. This has caused friction, the party admits. Donors expected recompense for their past support. But the PKR is anxious to distance the party from UMNO's brand of patronage politics. Its leaders also know that any hint of corruption will be pounced on by law-enforcement agencies run by UMNO appointees.

For all its wobbles, though, Mr Anwar's coalition is still intact. It runs four Malaysian states, including two of the richest. It is still dogged by ideological and interracial squabbles; but the same is true of BN, which is held together by the shared spoils of office and not much else. Its main ethnic-Chinese party has been without a ▸▸

leader for several months. The opposition still represents a potent threat to BN, particularly as more young voters join the rolls. But the loss of Mr Anwar's talents would dent its chances. It might also spark more defections, putting BN closer to its goal of a two-thirds parliamentary majority, sufficient to redraw electoral boundaries.

Should the opposition crumble, as some in UMNO dearly hope, democratic choice would not be the only loser. Mr Najib's stuttering economic reform efforts would probably drift further or grind to a halt. Malay ethnic-nationalists are already resisting changes to the affirmative-action policies that enrich UMNO cronies and deter investment. Mr Najib has sold his party on the idea that change is necessary to win elections. A neutered opposition would deal his reforms the death blow. ■

Tiananmen Square's buildings

Don't tell anyone

BEIJING

China's parliament is used to being ineffectual; its new offices are invisible

IN THE south-west corner of Tiananmen Square, a grandiose new building looms behind a shabby row of low-rise structures facing the plaza. These will be bulldozed in the coming months, unveiling in its full glory a monumental edifice that will be the first new structure in the square since Mao Zedong's mausoleum was plonked in the middle of it in 1977. The authorities, however, seem oddly sheepish about the new arrival.

Few but the most observant of Beijing residents are yet aware that the appearance of the city's most famous landmark is soon to change. The official press has largely kept quiet about the new building, which occupies what used to be a block of slum-like courtyard houses of pre-Communist vintage, together with a school and some offices and shops. The edifice is about half the size of the Great Hall of the People, to its north, a 1950s building which houses China's parliament, the National People's Congress (NPC). It shares its dour mien.

It took just 18 months from the laying of the foundation stone in February 2008 to its topping out ceremony last year. Yet the Chinese media have been coy about this feat, and the painstaking relocation further down a side road to make way for it of the historic 1920s' building that was once home to the All-China Journalists' Association. A government website briefly described the topping out ceremony, but did not say where the building-site was. It identified the project, however, as the "NPC Office Building". It said workers had completed the outer structure (with a "high sense of political responsibility") a month before schedule.

Back in 2004 the Chinese press was a little less reticent. *Oriental Outlook*, a magazine controlled by China's government-run news agency, Xinhua, said then that plans for such an NPC office building had been suspended as part of efforts to rein in a bubbling economy. But Chinese sources say blueprints were quietly dusted off again in 2005. In December the following year the building was officially designated a "project involving state secrets", though its purpose was revealed in notices posted around the area in 2007 warning residents that their block would be flattened. The government ordered that the building be ready for use by the middle of this year. An NPC spokesman for the legislature refuses to give any details of the cost or confirm when the project would be finished. A budget of 1.3 billion yuan, or $190m, was submitted in 2003, sources say.

Since 2007 the Communist Party has been stepping up efforts to curb a rash of lavish office building by local governments. "We will strictly control the construction of office buildings for Party and government bodies", the prime minister, Wen Jiabao, cautioned again at this month's annual NPC session, which is likely still to be held in Great Hall of the People even after the new offices are ready. Mr Wen has reason to be furtive.

Australian politics

Opening shots

SYDNEY

The health-care debate Obama missed

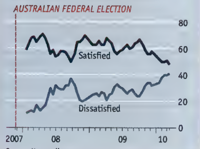
INSTEAD of welcoming Barack Obama to Australia, Kevin Rudd, the prime minister, was this week saddled with the ordeal of a televised debate with Tony Abbott, the opposition leader. The subject, health reform, mirrored the one that led Mr Obama to postpone his visit. At stake for Mr Rudd was his sweeping plan for the federal government to take over from the states most funding for Australia's 762 cash-stretched public hospitals. The first of several planned debates gave voters a foretaste of the federal-election campaign due later this year: Mr Abbott, the attack dog, against Mr Rudd, the unflappable, dry bureaucrat. According to television "worms", tracking viewers' instant responses, unflappable aridity won hands down: by 71% to 29%, says one network.

He badly needed the boost. An opinion poll a week earlier showed his approval rating at 48%, the lowest since he led the Labor Party to power in late 2007 (see chart). So far, voters have seen little from Mr Rudd's promise to change Australia with such projects as an education "revolution" and a high-speed broadband network. And his most cherished reform, an emissions-trading scheme to tackle climate change, is stuck in the upper house of parliament, where his government lacks a majority. In the press, the public service and privately in his own party, Mr Rudd's setbacks have sparked gripes about his attempts to micromanage policy.

The health plan he launched early this month allowed him fresh momentum. Australia's six states run and mostly pay for public hospitals. Crowded wards and lengthy waiting lists are common. The Treasury calculates that, in 35 years, health alone will consume the states' entire rev- ▸▸

Ruddy heck!

Satisfaction with the way Kevin Rudd is doing the job of Prime Minister, % polled



Source: Newspoll

enues, thanks to a growing and ageing population, and soaring costs. Mr Rudd proposes that Canberra almost double, to 60%, its share of hospital financing, and take over all aged-care costs. Many doctors' groups agree that tighter standards over how the money is spent will make hospitals more accountable. Ronald Penny, a doctor member of an inquiry that sparked the Rudd plan, argues the federal government should go further and spend more trying to prevent people needing hospitals at all: he cites figures showing one-tenth of teenagers drink enough alcohol to cause probable harm to their health later.

Winning the states over to Mr Rudd's centralist power grab is proving harder. His government has also proposed replacing the states' primary and secondary school curriculums with a national one in history, English, science and mathematics. George Williams, a constitutional expert, argues that both decisions are yet another blow to the states' roles in Australia's federal set-up. "Their existence is guaranteed, but their relevance isn't," he says.

Mr Rudd plans a showdown on his health plan with all six state leaders on April 19th. Unless all agree to relinquish their powers (Victoria and Western Australia are resisting loudly), he still has enough political capital to carry out his threat of holding a referendum on the issue at the federal election. The election's timing is up to Mr Rudd. Despite his own sliding popularity, the latest opinion poll gives the government a comfortable winning margin. Another poll shows almost 80% of Australians support the health plan. Mr Abbott's legacy as a health minister in the former conservative coalition government, which cut the federal share of health spending, hardly helps his cause. ■

Japanese politics

Self-immolation thwarted

TOKYO

A lone crusader takes on the DPJ's big guns—and survives for the time being

AS ONE of 15 deputy secretaries-general in the ruling Democratic Party of Japan (DPJ), Yukio Ubukata may often have found it hard to make his voice heard. Not in the past week. With his disarmingly unaffected manner, the veteran member of parliament has hit the airwaves denouncing what he calls a dangerous concentration of power and money in the hands of his boss, Ichiro Ozawa.

He knew it was a strategy with a high risk of self-immolation. Mr Ozawa is the DPJ's secretary-general. As the architect of its landslide election victory last August, he is widely regarded as the most powerful politician in Japan. Even Yukio Hatoyama, the prime minister, yields before him.

Ozawa, surprisingly vulnerable

What is more, Mr Ubukata complains, Mr Ozawa controls all the DPJ's funds and allocates them to his most loyal supporters. He selects which candidates the party will endorse to run for it during elections. Such influence makes it very hard for fellow party members to lend public support to any revolt against him. "Ozawa-*san*'s way of handling politics is to give money only to people who share his opinion. That is what is distorting democracy within the party. Because of that, no one can stand up to him. That is the source of his power," Mr Ubukata says.

Such incendiary claims could easily be dismissed as the rants of a man with a grudge. But, compellingly, Mr Ubukata has continued to voice them even after Mr Ozawa and Mr Hatoyama personally intervened on March 23rd to stop the party sacking him for his insubordination.

By his account, his brief meeting with Mr Ozawa to secure his future verged on the surreal. After they had both agreed that he should stay on in his post, Mr Ubukata tried to air his grievances to his boss, notably his concerns about the increasingly authoritarian nature of his leadership. But, he says, Mr Ozawa left the room abruptly, saying he had no time to discuss such matters.

For policy wonks, the rift has a philosophical aspect, in a country that has only just emerged from half a century of monolithic one-party rule. Since he first joined the opposition in 1993, Mr Ozawa has argued for a reformed parliamentary system in Japan, modelled on Britain's House of Commons. He believes the government and ruling party should work together under a strong prime minister, with backbenchers kept in line by a party whip. This, he believes, would end the murky consensus politics that has made decision-making in Japan so hard.

But Mr Ubukata believes such a system is a waste of the many backbenchers among the DPJ's 423 elected politicians. He wants them to help make policy in Japan, rather than sit idly on the sidelines. This, he says, is what the DPJ stood for when it promised to overhaul a corrupt, decades-old system in which policy was made by bureaucrats and rubber-stamped by elected officials. He also wants the party to craft its own policy proposals, rather than wait for orders from above.

He admits to being disappointed that his one-man crusade did not set off a broader revolt. The "seven magistrates" in the cabinet who are opposed to Mr Ozawa by and large kept their heads down—perhaps betting that Mr Ozawa and Mr Hatoyama will be ousted anyway this summer if the upper-house results are bad.

That is not good enough for Mr Ubukata, who believes Mr Ozawa, embroiled in campaign-finance scandals since last year, should resign well before the upper-house elections, to give the DPJ time to rebuild its credibility. He may get his way. The rare hint of vulnerability shown by Mr Ozawa in keeping Mr Ubukata on may be a sign that the end is nearly upon him. ■

Democracy in Afghanistan

Wise council

BEHRE KAMAL

Village-development councils are taking on more serious roles

IT TOOK a while to sort out Jama Khan's estate, a small plot at the foot of the Hindu Kush. Endless wars had made refugees of the whole village. What government they had was remote, slow and corrupt. And so Jama Khan's land lay fallow for 30 years after his death, his family squabbling over his inheritance all the while.

Until, at long last, the village itself intervened. In the absence of formal government, and even of a traditional council of respected elders, or *shura*, the local-development council was left to take charge. After consulting the village *mullah*, it allotted half the land to Jama Khan's brother, with half to be divided between his two sisters; for Islamic law says a woman shall inherit half of a man's share. Thus the matter was resolved.

As Afghanistan's bloody insurgency has worsened over the past few years, critics at home and abroad complain that it was a mistake for the West to try planting such an alien institution as democracy in this rugged land. The debacle of the 2009 elections sharpened their scepticism.

The ostensibly democratic government in Kabul is indeed a mess. But there are signs that in quiet corners of the country, local democracy is making strides. Devel-

opment councils, established in many villages in 2004 to manage the national government's development programmes and staffed by locally elected citizens, have flourished in many places. The National Solidarity Programme (NSP) finances small-scale projects—water pumps, small dams, hydropower generators—chosen by the councils themselves. The idea is that locals know their own needs better than do remote ministries and foreign agencies. Annual audits, in which the books are checked publicly and the councillors subjected to questioning by other villagers, are said to be lively affairs. By last April the NSP had spent $593m this way, an average of $33,000 per village per year.

In some places the system has become so popular that after the annual funding runs out the villagers find other sources to petition for further projects—foreign NGOs for example—or even pool resources among themselves. In Behre Kamal, in Baghlan province, locals raised $16,000 to build a mosque. In nearby Markaza Khinjan the local council launched women's education courses. "We're not just spending the government's money. We're planning for our future," says Abdul Jabar, the council's chairman, beaming with pride.

Councils have begun picking up responsibilities that were abandoned by the government. In a country where many official institutions are paralysed by incompetence and corruption, there is an obvious void. When development councils have stepped in, they have sometimes pushed aside the *shuras*, which tend to be composed of the richer and more powerful villagers. Jama Khan's relatives had tried to get the district court—three hours' drive each way—to settle their inheritance dispute. But the case dragged on endlessly, the judge demanding bribes from both parties. In the end, they turned to the one body they trusted. "This is better than a faraway court. We live here, we know these things better," explains Mahmad Azar, Behre Kamal's council chair.

These councils are now settling ordinary criminal cases as well as family disputes. Markaza Khinjan's council stopped the practice of using women as payment in blood feuds, with guidance from the Aga Khan Foundation, an NGO that trains many of the councils. The foundation has praised the councils' responsiveness to local needs. It also suggests that the rigour of standing for election may have helped focus the minds of the councillors.

To be sure, elections alone are no guarantee of anything. Corruption may become a greater problem. And some councils have been hijacked by local strongmen just the same. But even that is not all bad: it suggests the bullies are starting to recognise the councils' power. In the life of Afghanistan's villages even a modicum of democracy is worth something. ■

Girija Prasad Koirala

Democrat, dynast and dealmaker

KATHMANDU

The death of G.P. Koirala adds more uncertainty to Nepal's peace process

HE WAS, said Manmohan Singh, India's prime minister, in a typically South Asian phrase, "one of Nepal's tallest leaders". After Girija Prasad Koirala's death on March 20th, at the age of 86, thousands of Nepalis watched his funeral cortège carry his body to its cremation. As so often, death made his faults seem petty; and dwelling on them unseemly.

After all, Mr Koirala was the man who led Nepal to democracy, of a sort, after the abolition of absolute monarchy in 1990; and he played a big part in bringing peace, of a sort, when Maoist rebels ended their ten-year insurgency in 2006. So his death leaves a big hole in Nepal's polity. Even Baburam Bhattarai, the Maoists' ideologue, who was instrumental in preventing Mr Koirala from finishing his career as Nepal's president, paid lavish tribute. Mr Koirala's "counselling and guidance", he wrote, were needed in the coming months.

By the end of May, Nepal's squabbling political parties are supposed to agree on a new constitution. Since they are still at odds on the most basic issues this seems improbable. Nor is there much progress on the Maoists' demand that their forces be merged with the army. Uncertainty will persist if, as is possible, there is a six-month extension to the present interim arrangement. Or there might be a period of "presidential" emergency rule to force the constitution-drafters to produce a document.

So Mr Koirala will be missed. Broking deals was his forte. Politics was in his blood. Three of his five brothers became prime minister. They were active in the Indian independence struggle and, when it succeeded, founded the Nepali Congress party to fight for freedom at home. Girija worked in the Biratnagar jute mill, Nepal's first industry. He organised its first strike, which led to his first stint in prison.

After a popular movement brought democratic reform in 1990, Mr Koirala served four terms as prime minister. None lasted much more than a year. Corruption scandals and power struggles would bring his governments down, only for him to return to office in short-lived coalitions put together in murky back-room deals. When the Maoist rebellion was in its infancy he responded disastrously, ordering brutal police repression that forced more peasants into the arms of the rebels.

His many faults as a leader earned him the loathing of many Nepalis and spread disillusion with electoral democracy itself. Capitalising on this, King Gyanendra restored absolute monarchy in 2005. Yet Nepalis resisted and another popular movement a year later toppled him, and Nepal became a republic. Mr Koirala, an ailing and tarnished veteran, was the uncontested choice for prime minister.

But when elections were held in April 2008 Congress and the other mainstream parties were shocked to find themselves beaten at the ballot box by the Maoists, who formed a short-lived government. The Maoists, however, frustrated at their inability to control the army and rule the country, quit government last May, leading to the present stalemate. Mr Koirala might indeed have played an important role in ending it. But like the rest of the Nepali elite, he seemed not to accept the people's electoral choice. He also lost friends by insisting that his disliked daughter, Sujata, become a deputy prime minister. A reluctant republican, he backed the monarchy until King Gyanendra's rule became intolerable. But he remained a dynast. ■

Farewell to a tarnished hero

Banyan | A matter of life and death

Setbacks for opponents of capital punishment, but they are making more progress than meets the eye

BELIEVERS in "progress", or at least those of a mutton-chopped, European variety, hold to a kind of ascent of man. First comes spreading prosperity. Then representative government replaces tyranny. Finally, notions of human rights, social justice and the fallibility of the state extend even to death row, and the judicial terror of capital punishment is ditched. Last year was the first in Europe's recorded history in which not one person was executed.

On the face of it Asia stacks up not at all well against this achievement. The region accounts for just over half the world's population. Prosperity has spread, and representative government. But in its application of the death penalty, Asia leads the world. Some 95% of Asians live in jurisdictions that carry out capital punishment, and Asia accounts for over three-quarters of executions worldwide.

South Korea has not carried out a death sentence in 13 years. Yet in late February the Constitutional Court ruled that the death penalty as prescribed in the criminal code did not violate the constitution. This alarms the country's legal scholars. The 110-odd crimes qualifying for the death penalty include corporate offences and "criminal ideological violations"—a throwback to South Korea's dictatorial days.

And this month in Taiwan the justice minister, Wang Ching-feng, suddenly resigned. A Buddhist, she fiercely protected the lives of 44 death-row convicts. The president, Ma Ying-jeou, a former Harvard law student, was also thought to oppose capital punishment. But his party, the Kuomintang, is sagging in popularity before year-end elections. Miss Wang's stance cost her her job. On March 22nd a new justice minister was sworn in, hinting that the official killing would begin again.

Yet dig a little deeper, and the picture looks different, even hopeful. In December the UN General Assembly votes on calling for a global moratorium on capital punishment. Abolitionists lobbying Asian governments will find a better reception than you might think. Naturally, Asian statistics are skewed by China, alone accounting for over nine-tenths of all Asian executions. But even Chinese executions have seen a precipitous fall. A best guess is that 5,000 were executed in 2008, giving a rate per head of population dozens of times higher than the United States. Yet this represents a drop of two-thirds from a decade earlier.

China's penchant for execution is explained by a dictatorship which has a low regard for citizens' rights and uses violence as an instrument of state power. But an official policy of "kill less, kill carefully" is taking root. All capital cases now have to be reviewed by the Supreme Court, which is said to approve only a tenth of cases, a remarkable change, if true. So even in China development seems to have bred a less punitive state. Perhaps a human-rights dialogue between China and the EU, long derided by liberal critics, is actually doing some good.

Another populous country, India, is also "retentionist", but from 1999 to 2008 it executed just one man. For Asia as a whole, according to David Johnson and Franklin Zimring writing in the online *Asia-Pacific Journal*, 16 out of 29 jurisdictions have abolished the death penalty, either definitively or in fact, whereas 13 retain it. In January Mongolia, with a history of murky executions, was the latest to declare a moratorium. The death penalty, said President Tsakhia Elbegdorj, was an act of state violence that ran the risk of irrevocable error, and neither deterred criminals nor restored justice to victims' families.

Even in South Korea and Taiwan, there is probably no profound change of course. Both democracies emerged from mid-century authoritarian rule marked by an orgy of judicial and extra-judicial killings. These are now in the past: one democratic president of South Korea, the late Kim Dae-jung, was himself sentenced to death in 1980, before reprieve. NGOs now lobby for convicts' rights, and lawyers argue that the issue is not between death-row convicts and the rest of the citizenry but of overweening state power over all.

Like nearly all countries considering abolition, in Taiwan people are overwhelmingly against it, but abolitionists, including Mr Ma's former Harvard professors, hoped the president would lead from the front. Both countries are concerned about their international reputation, including among Europeans. And each is in soft-power competition for legitimacy with a bloody, authoritarian rival. Before too long, both may fall into the abolitionist camp.

Rich, plural and cruel

Outliers remain. Until recently, rich, sophisticated, peaceable Singapore killed as high a proportion of its population as does China. And in Japan executions have risen sharply in recent years. Quite apart from known miscarriages of justice, the country's penal habits are chilling. Its death-row inmates, in solitary confinement, are allowed few visits from family or lawyers. They must sit all day on their bed, with rules dictating even their postures, and may not look their guards in the eye. After waiting usually years, they are hung, always during a parliamentary recess, with only a couple of hours' notice, with the family informed only when it is told to pick up the body. With high rates of mental illness from the stress, this is bureaucratic killing at its cruellest.

How to explain these exceptions to the model of "progress"? Perhaps, Mr Johnson and Mr Zimring argue, by realising that both countries, although structurally pluralistic democracies, have long been in practice under one-party rule. But recently executions in Singapore have fallen by nine-tenths. In Japan the fall from power last year of the Liberal Democratic Party may signal change. The new justice minister, for one, is an abolitionist and has signed no death warrants. Asia has yet to prove those old European dreamers wrong. ■

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Also in this section

Israel, America and the world

A wall of suspicion

JERUSALEM AND WASHINGTON, DC

Israel's prime minister has received a rare dressing down from the American president. But he shows no sign yet of backing down

GLUM Israelis likened the event to thieves entering in the night. When Binyamin Netanyahu and his aides met Barack Obama in the White House on March 23rd, the president forbade any media coverage—not even a quick photograph—in the Oval Office. The encounter with Israel's prime minister did not seem to lead to the jovial reconciliation that politicians on both sides, after a fortnight of angry mud-slinging between Washington and Jerusalem, had hoped for.

The format was as odd as the extreme confidentiality. After the two leaders had sat alone for an hour-and-a-half, Mr Netanyahu closeted himself to "consult" his advisers, before returning for another half-hour discussion. Did Mr Obama, riding high after his historic victory over health care, choose to confront the silver-tongued Israeli prime minister with an unequivocal challenge to lay out his policy on peace with the Palestinians—and to back down over the controversial issue of building Jewish houses in Israeli-annexed East Jerusalem, which Palestinians see as the capital of their would-be state?

The need for such clarity was illustrated by yet another Israeli building project in East Jerusalem, which was publicised just hours before the White House meeting. In Israel there was speculation that someone had issued news of this untimely project, long in the works, in order, once again, to "trip up Bibi", as the prime minister is known, when he was about to meet the president of Israel's most vital ally.

The crisis in American-Israeli relations flared up a fortnight ago when, just as the vice-president, Joe Biden, was visiting Jerusalem, it was announced that 1,600 Jewish homes would be built in East Jerusalem. Mr Netanyahu apologised fulsomely for the bad timing but refused to rescind the decision. The suburb in question, Ramat Shlomo, is one of several all-Jewish ones built since 1967 in East Jerusalem, where 250,000 Israeli Jews now live.

The latest scheme is much smaller—just 20 units—but a lot more incendiary. Whereas Ramat Shlomo is built on a rocky outcrop on the northern rim of the Israeli-delineated municipality, the new scheme involves installing a score of Jewish settler families in a converted hotel in the densely populated all-Arab suburb of Sheikh Jarrah, close to the Old City.

Mr Netanyahu contends that his building policy in Jerusalem is no different from that of all his predecessors since 1967, when Israeli forces conquered the entire city. "The Jewish people were building in Jerusalem 3,000 years ago," he told 7,000-odd delegates to the annual conference of the influential American Israel Public Affairs Committee (AIPAC), a pro-Israel lobby, in Washington on March 22nd. "And the Jewish people are building Jerusalem today. Jerusalem is not a settlement. It is our capital." He complains privately that Mr Obama is needlessly picking on him.

But American officials complain privately that Mr Netanyahu is dissembling. They point out that two of his predecessors, Ehud Barak (1999-2001) and Ehud Olmert (2006-09), negotiated with the Palestinians over a peace plan for Jerusalem proposed by President Bill Clinton, who suggested sharing out the city's sovereignty by districts: Jewish-inhabited ones would go to Israel, Arab-inhabited ones to Palestine. The "holy basin" in the middle, including religious shrines, would fall under an international or divine protectorate.

Mr Obama now insists that Jerusalem, along with the other core issues of the conflict, such as the question of redrawing borders and the return of refugees demanded by the Palestinians, should be tackled in the "proximity talks" he is trying to launch between Israelis and Palestinians. He hopes they may lead to a resumption of long-stalled direct negotiations. Mr Obama also wants a series of "confidence-building steps" to bring the Palestinians back to the table. These include a release of Palestinian prisoners and the dismantling of Israeli military road-blocks that frustrate Palestinians' lives and commerce on the West Bank. Mr Netanyahu says he cannot meet these demands because his allies on the nationalist and religious end of his ruling coalition would rebel if he did.

But Mr Obama's team may no longer be willing to accept that as a reason. Some observers in Washington felt in his speech to AIPAC Mr Netanyahu gave unduly short shrift to Mr Obama and ignored the president's insistence that fresh talks between Israel and the Palestinians should go straight to the big issues, such as adjusting borders. "Of course the United States can help the parties solve their problems," said the prime minister. "But it cannot solve the problems for the parties. Peace cannot be ▸▸

imposed from the outside."

It was even suggested that Mr Netanyahu's speech may have been written before Mr Obama's health-care triumph in the House of Representatives the night before. It was said that people in the White House had been brooding with resentment over Mr Netanyahu's ill-disguised pleasure when Mr Obama's political fortunes seemed earlier to be sliding.

Mr Netanyahu has indeed had a tough time keeping his coalition together. Just before he left for Washington, he and his extreme nationalist foreign minister, Avigdor Lieberman, both secular Jews, persuaded a cabinet majority to accept ultra-Orthodox demands for a new hospital emergency-room to be moved, at high cost, because its previously planned site might contain ancient Jewish graves. An ultra-Orthodox party that is an important coalition partner and holds the health ministry threatened to secede unless this was done.

A public outcry ensued. Already in Washington, Mr Netanyahu had to backtrack by setting up a committee to "reconsider" the cabinet decision. But for now, he would rather compromise with his Orthodox partners than consider the prospect, favoured by Mr Obama's team, of dumping them (and, by the by, Mr Lieberman's lot) and co-opting the more pragmatic Kadima party, under Tzipi Livni. After winning most seats in a general election a year ago, Ms Livni refused to join a coalition with Mr Netanyahu, partly because he would not negotiate over Jerusalem.

The world gangs up on you

As if Mr Netanyahu had not been discomfited enough by his apparent dressing down from Mr Obama, he faced yet another embarrassment when Britain's foreign secretary, David Miliband, publicly denounced Israel for forging 12 British citizens' passports that were used in January in the assassination of a senior Hamas man in a hotel in Dubai. An Israeli diplomat in London, thought to be a member of Mossad, the external intelligence service, was asked to leave the country.

Palestinians have gleefully watched two of Israel's main allies rebuking it. They have rejoiced, too, as the peacemaking Quartet (the United States, the European Union, Russia and the UN) roundly condemned Israel's building plans in East Jerusalem. Earlier the EU's Court of Justice had said that Israeli products made in West Bank settlements should not be given EU preferential trade tariffs.

Mahmoud Abbas, the Palestinian leader, echoed Mr Obama's demands for a settlement freeze in East Jerusalem, but he is wary of once again being left high and dry if the Americans were to buckle over the issue, as they have done before. Moreover, he is nervous that the violence between Palestinian protesters and Israeli security forces, which has increased in the past few weeks, may spin out of control. Four Palestinians have recently been shot dead in the West Bank. So far Palestinian and Israeli forces have co-operated rather effectively to contain the unrest. Even so, Palestinian leaders are worried that a wider *intifada* (uprising) may erupt, making it even harder to get talks going again.

Some Palestinians might settle for an Israeli assurance that settlement-building in East Jerusalem would cease while talks are under way, along with an Israeli promise to negotiate borders and security immediately. But Mr Abbas is unlikely to risk re-embarking on talks without the 22-country Arab League's endorsement. The league's impending summit is to take place in Libya, whose leader, Muammar Qaddafi, is keen for Mr Abbas's Islamist rival, Hamas, to attend—a sure recipe for kiboshing a compromise plan to resume talks. ■

Iraq's election

Wheels within wheels

BAGHDAD

All sorts of ruling combinations may yet emerge—after months of wrangling

WITH the count almost complete, it is impossible to say who will head the next Iraqi government. The electoral alliance with the most seats will have first shot at forming one—but with no guarantee of success. The likeliest contenders are the prime minister, Nuri al-Maliki, and Iyad Allawi, one of his predecessors. But a compromise candidate could yet slip through the middle, as has happened before. And several wily also-rans may hold the final balance of power.

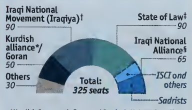
The latest figures put Mr Maliki's State of Law alliance a few thousand votes behind Mr Allawi's Iraqi National Movement, known as Iraqiya. A Shia religious alliance that includes followers of a populist cleric, Muqtada al-Sadr, was coming third, with a strong showing in the eastern slums of Baghdad and in three southern provinces. A Kurdish alliance, the fourth main block, swept the Kurds' three provinces in the north.

After the full result is known within a few days, the parties may have to wait several more weeks while voting disputes are resolved and seats in parliament allocated. A complex formula will boost representation for women and minorities (including Christians) and award extra seats to the largest parties. Only then will the winner be revealed. The group with the most seats will not necessarily have won most votes.

Neck-and-neck

General election results, estimated seat numbers

March 2010



*Kurdish Democratic Party and Patriotic Union of Kurdistan †Alliance led by Iyad Allawi ‡Alliance led by Nuri al-Maliki §Includes Ammar al-Hakim's Islamic Supreme Council of Iraq and group led by Muqtada al-Sadr

Source: *The Economist*

The slowness of the count contrasts with the frenetic pace of negotiations in Baghdad's hotel lobbies and party headquarters. No alliance has come even close to an outright win. Messrs Maliki and Allawi may get around 90 seats each in the 325-member parliament. Both face an uphill struggle to find a winning coalition. Their most obvious partners are the Kurds, who are part of the present government and will seek to stay on to defend their regional privileges. With two suitors wooing them, they will demand extra concessions.

But the Kurds are no longer the sole kingmakers. Assuming they act as one block, including a newish reform party called Goran (meaning Change) as well as the two older ones, their 50-odd seats would still not be enough to give either Mr Maliki or Mr Allawi the 163 seats they need to command a majority in parliament.

So the Iraqi National Alliance, an umbrella group for Shia religious parties that campaigned strongly against both men, may hold the final balance. Within that alliance, Mr Sadr has a role. But another part of the National Alliance, the Islamic Supreme Council of Iraq (ISCI), could also play a part, even though it did badly in the election, getting only a dozen seats. As part of Mr Maliki's current government, ISCI will also be keen to stay on board, enjoying the perks and patronage of office. But it strongly opposes Mr Allawi's anti-Iranian stance and in the past has quarrelled with Mr Maliki too. In any case, ISCI alone is too small to swing the balance.

Mr Sadr has more clout. He commands a militia known as the Mahdi Army that in the years after the toppling of Saddam Hussein battled ferociously against American, British and Iraqi government forces. In ▸▸

the election he cleverly exploited a legal provision letting voters rank candidates within an electoral block. His disciplined movement marshalled supporters to vote for specific candidates at the expense of others in his wider alliance. So in Baghdad, 11 of the 16 seats won by the National Alliance may go to Mr Sadr's people. Overall, he may control up to 40 seats, perhaps enough to give Mr Maliki or Mr Allawi a majority together with the Kurds. But his price for co-operation is unclear.

The election results paint a spotty picture of Iraqi democracy and political attitudes. Support for Mr Allawi, a secular Shia who once belonged to Saddam's Baath party, exceeded expectations. But that does not mean his brand of non-sectarian politics has prevailed. Much of his support comes from disaffected Sunnis in the north and west and from pragmatic, secular-minded Shias in Baghdad. Mr Allawi got almost no seats in the swathe of Shia-populated provinces in the south.

For his part, Mr Maliki got most of his backing from a core constituency in the south and in the Shia parts of Baghdad. He may not win a single seat north of the capital. So the main race is between two moderate lists, each with a sectarian and geographic tilt. That is better than last time, in 2005, when the divide was between Shias, who voted en masse, and Sunnis, who largely boycotted the poll.

Another change is the thinning out of small parties. Iraq's new political system favours large coalitions. The Unity Alliance, a cross-sectarian competitor to Mr Allawi led by Jawad al-Bolani, the interior minister, was almost wiped out. In Kurdistan the reformists of Goran, which did well in regional elections a year ago, failed to make headway. Yet even the minnow parties may suddenly acquire influence if the coalition of Mr Allawi or Mr Maliki falls just shy of a majority.

Or the two men may consider forming a government of national unity. Their views are much closer than their fierce and rhetorically exaggerated campaign rivalry suggests. Together they would have a comfortable majority—and a chance to reconcile Iraq's two main Muslim sects. The trouble is that neither man can abide the idea of playing second fiddle. In the end, one of them—or both—may have to be shoved off the stage by ambitious lieutenants capable of reaching across the aisle. ■

Arab women's rights

Some say they don't want them

CAIRO

The battle goes on, though men often object—and sometimes women too

THE sight of hundreds of women cheering a proposed law banning child marriage, as they did on March 22nd in the Yemeni capital, Sana'a, was hardly amazing. No country has escaped the global trend towards greater equality between the sexes, not even one as poor and tradition-bound as Yemen, where half of girls are married off before the age of 18 and many even before the age of 10. Yet the day before that demonstration even more women (pictured right), nearly all wearing full face veils, gathered at the same spot to denounce the law as an imposition of unIslamic, Western values.

Yemeni women who favour child brides

Arab women have made huge if uneven strides since the issue of their rights arose a hundred years ago. Female education, for instance, was once virtually unknown. Today, even in arch-conservative Saudi Arabia, two-thirds of university students are women. But still, among 134 countries in the latest Global Gender Gap Report prepared by the Swiss-based World Economic Forum, a survey that measures opportunity for women in education, health, business and politics, all 14 of the Arab countries that were included ranked in the bottom 30.

Not surprisingly, Yemen came last of all. But the clashing demonstrations in its capital illustrated an important aspect of the Arabs' lag in women's rights. Quite often the obstacles to their progress have been not just ill-educated male chauvinists and conservative clerics. Women themselves have also stood in the way.

In the relatively liberal and rich emirate of Kuwait, for instance, women got the right to vote five years ago and won their first seats in parliament last year. But to get there, reformists found themselves battling not only against apathy among many women but even deep-seated female hostility. By contrast Syria, long secular under the Baath party's rule, denies political rights without sexual discrimination. But veiling and other forms of pious ostentation among women have recently returned, largely because of groups such as the Qubaysiyat, an all-female Islamist society which has schools, nurseries and mosques that now attract many of the Syrian elite.

Egyptian women, who fought to drop their veils in the 1920s and have voted since 1956, have made very slow progress ever since. Many retain deeply traditional outlooks. A survey in 2009 of 15,000 Egyptian youths, for instance, found that 67% of female respondents believe that a husband is justified in beating his wife if she speaks to another man. By contrast, a recent initiative by Egypt's government to appoint female judges roused little general protest. But fellow members of Egypt's ostensibly secular judiciary have proved harder to convince. Last month some 334 out of 380 judges on the state council, a grand body that adjudicates cases between individuals and the state, voted against accepting female members. The matter is still pending. Egypt's supreme court has now ruled in favour of women judges but deferred a final decision to yet another all-male panel.

So the bigger share of blame for Arab women's slow progress still lies with the usual suspects, namely men. Saudi Arabia recently ruled that female lawyers may actually appear in court. But the concession was heavily qualified. Women will be able only to represent women—and only in family cases.

Ethiopia's elections

Forget about democracy

NAIROBI

The chances of a fair vote in the coming election are fast receding

THE United States, the richest and most powerful nation on earth, is also the most generous donor to one of the poorest, Ethiopia. America says it gives $1 billion in aid every year to Africa's second-most-populous country, which also happens to host the African Union's headquarters.

Yet Barack Obama's administration has barely stirred itself to protest against recent attempts by Ethiopia to jam programmes in Amharic, the country's main language, beamed by the Voice of America, a respected state-funded broadcaster. Ethiopia's prime minister, Meles Zenawi, brazenly says he will continue to jam the signal for as long as it incites what he calls hatred. He has compared the Amharic service to the hate speech spewing from Radio Mille Collines, which helped provoke Rwanda's

Meles holds his nose, gets the cash

genocide in 1994. The State Department called the comment inflammatory but seems loth to make Mr Zenawi suffer for it.

One reason is that the Pentagon needs Ethiopia and its bare-knuckle intelligence service to help keep al-Qaeda fighters in neighbouring Somalia at bay. Many of Washington's aid people argue that, though Mr Zenawi is no saint, he still offers the best chance of keeping Ethiopia together; even now, as one of the world's least developed countries, it cannot feed itself.

Human-rights campaigners think the limpness of America and European Union countries, especially Britain, in the face of Mr Zenawi gives him a free rein to abuse his own people. This week's report by Human Rights Watch, a New York-based lobby, claims that, after 20 years in power, Mr Zenawi's ruling Ethiopian People's Revolutionary Democratic Front has "total control of local and district administrations to monitor and intimidate individuals at a household level." With a general election due on May 23rd, opposition supporters, says the report, are often castigated as subversives by the government, denied the right to assembly, and harassed. The press has been "stifled". Newspapers avoid writing about opposition parties or people the government says have terrorist links.

Furthermore, says Ben Rawlence, who wrote the report, "Meles is using aid to build a single-party state." Foreign governments, he says, have colluded in eroding civil liberties and democracy by letting their aid be manipulated by Mr Zenawi. Because of his party's stranglehold at village level, its members can decide on entitlements such as places for children in school and the distribution of food handouts. Peasants who back the opposition get less. Farmers complain they are denied fertiliser for the same reason.

The Ethiopian government has denounced the report as outrageous and ridiculous. Mr Zenawi says that groups such as Human Rights Watch interpret human rights too narrowly. The only way to guarantee Ethiopia a free future, he argues, is to keep it stable while it continues to develop. His political calculations are straightforward. He reckons, for instance, that reporting by the Voice of America does more harm inside the country than outside criticism of his censorship.

In any case, Mr Zenawi has signed up for a code of electoral conduct and invited foreign election observers in. He still has time to win over critics before the election, for instance by freeing an imprisoned opposition leader, Birtukan Mideksa, as a goodwill gesture.

Aid-giving governments, for their part, are unlikely to change their minds. Even after hundreds of protesters were shot dead by the police after the last elections in 2004, aid to Ethiopia was only repackaged in different forms, not suspended. Besides, foreign politicians have promised their own voters that they will dish out large amounts of aid and argue that at least Ethiopia is less corrupt than many other African countries. Mr Zenawi understands this well—and exploits it. ■

West Africa's regional club

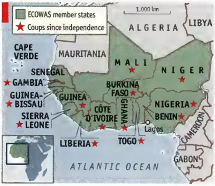
Quietly impressive

LAGOS

As others falter, one regional club has notched up some successes

THE Economic Community of West African States, better known as ECOWAS, has a notoriously tricky job. The 15-country club must, among other things, promote democracy in a region blighted by military coups and "big men" who rarely wish to cede power. Four of its members have suffered civil wars in the past 20 years; only Cape Verde and Senegal have never had a coup since independence. Yet, especially compared with Africa's other such clubs, ECOWAS is doing a pretty good job.

Guinea and Niger, two resource-rich but coup-prone countries, have recently provided big tests. In the first case ECOWAS rose to the challenge. Last month Guinea's junta finally handed over power to a transitional government after a concerted squeeze by ECOWAS, other African countries and the West. ECOWAS had taken the lead, holding talks with the soldiers and pro-democracy groups since October. It had also suspended Guinea from the club and had put sanctions on the regime of Captain Moussa Dadis Camara, who seized power in 2008 after the death of General Lansana Conté, a dictator who had run the show for 24 years.



Meanwhile, last month Niger had its third coup in 14 years. The African Union (AU), the main continental body, promptly suspended the country from membership after soldiers ousted Mamadou Tandja, the president. But ECOWAS had suspended the impoverished desert state four months earlier, as Mr Tandja grew ever more tyrannical, seeing that his latest moves, if unchecked, would provoke the army to intervene. ECOWAS and the AU are now monitoring the soldiers' promise to hold elections in the coming months.

ECOWAS concedes it can achieve little on its own. Its sanctions are largely symbolic. Many of its members still rely financially on their old colonial masters and, increasingly, on resource-hungry emerging powers. In 2008 China signed a deal worth $5 billion to pump Niger's oil.

To compensate for its lack of economic clout, ECOWAS has learnt to work in tandem with beefier bodies and countries, raising the alarm when it spots danger on the horizon. Guinea's junta started to fall apart only after the slaughter of at least 150 demonstrators in September provoked an international outcry. In Niger it was ECOWAS's alliance with the AU and the West that made things shift. The Southern African Development Community (SADC), another regional club of 15 countries, which has been so feeble over Zimbabwe, could learn a trick or two from ECOWAS.

The club's Achilles heel is Nigeria, Africa's most populous country. Its economy is twice as big as the other members' combined. The club's headquarters is in Nigeria, which, on some counts, provides a third of the cash for ECOWAS and a big chunk of its peacekeeping troops.

But this makes it hard for the other ECOWAS members to criticise Nigeria. Umaru Yar'Adua, the country's ailing president, has not been seen in public for almost four months, yet refuses to hand over the running of the country fully to Goodluck Jonathan, his deputy. Militants recently planted bombs outside local-government offices in Nigeria's oil-producing region, and hundreds were killed earlier this month in ethnic violence in the country's central area. Yet, when it comes to dealing with Nigeria's flaws, "ECOWAS is strangely absent," says Alex Vines of Chatham House, a British think-tank. ■

Also in this section

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France's regional elections

The people say "Non!"

PARIS

The French voters blow a raspberry at their president

THE only consolation that President Nicolas Sarkozy can take from the defeat of his UMP party in France's regional elections on March 21st is that it could have been even worse. In the end, the party held on to Alsace, one of only two regions out of 22 in mainland France that it held beforehand. But it lost Corsica, which the right had run for the past 26 years. Overall, the UMP took only 35% of the national vote, against 54% bagged by the Socialist Party and its friends. With the left in triumphant mood, and just two years left before the 2012 presidential election, how much trouble is Mr Sarkozy in?

In some ways, this was a classic midterm sanction. French regions have relatively few powers. Voters care little, and know even less, about them. Christine Lagarde, the finance minister, confessed that her sons had not voted in the first round because they "couldn't understand a thing about the regions". At a time of sluggish growth and 10% unemployment, voters duly took the chance to register a protest against the party in power.

Many did this by staying at home (fully 49% abstained); others responded by drifting to the extremes. The far-right National Front took nearly 18% in the 12 regions in which it had got into the run-off. Jean-Marie Le Pen, its thunderous 81-year-old leader, pulled in 23% in the south of France. His equally fiery daughter, Marine Le Pen, won 22% in the north.

But the apathy of one-time Sarkozy voters helped above all the Socialist Party and Europe Ecologie, its main partner, which chalked up handsome victories. Ségolène Royal, the presidential loser in 2007 and now president of Poitou-Charentes, was re-elected with a hefty 61%. According to Pascal Perrineau, a political scientist, as many as 11.5m voters who had backed Mr Sarkozy for the presidency in 2007 failed to support the UMP this time.

Before the poll, Mr Sarkozy had insisted that this was a regional vote that would have only regional consequences. He ruled out changing his prime minister, François Fillon, whom he kept in the job this week. In a minor reshuffle that may not preclude a bigger one later in the year, Mr Sarkozy retained all the big names. But Xavier Darcos, the hapless labour minister, was pushed out of the government after polling just 28% in Aquitaine.

Yet it would be wrong to read too little into the result. For the first time, Mr Sarkozy has begun to look fallible. His popularity rating fell to 36% in March, its lowest since he took office, according to Ifop, a pollster. Some 58% of respondents, including 21% of his own supporters, told another poll that they did not want him to stand again in 2012. Voters seem confused about where Mr Sarkozy is heading, as he lays into capitalism with one breath even as he urges the French to become more competitive with the other. They are growing disillusioned because of his inability to keep his promises to stem industrial decline and job losses. And they are uneasy about planned pension reforms. Trade unions staged street protests this week, vowing to resist any moves to raise the legal retirement age from 60.

Perhaps most worrying of all, even some on Mr Sarkozy's own side are starting to query his judgment. Why did he launch a pointless months-long debate about "national identity" if it led only to the resuscitation of the National Front? Why did it take him so long to realise the mistake of letting his undergraduate son run for the head of the board overseeing the development of the La Défense financial district, in Paris?

Until now, Mr Sarkozy has kept such a tight grip on his party that any such doubts were seldom voiced within it. Almost his only critic has been Dominique de Villepin, a former prime minister and fierce personal rival, who now plans to set up his own party on the right. But Gaullist grandees and ambitious youngsters alike have begun to speak out. They are fed up with his policy of borrowing figures from the left for top posts. "The Socialists take the jobs, don't say thank you, and win the elections," quipped one. They also argue that Mr Sarkozy's whirlwind of reforms is too confusing. Jean-François Copé, the UMP parliamentary leader, has urged him to "return to fundamentals". François Baroin, a minister under Jacques Chirac, has said he should slow down reforms altogether.

Mr Sarkozy's response? This week, he brought Mr Baroin into the government as budget minister, replacing Eric Woerth, who takes Mr Darcos's place at the labour ministry and is thus in charge of the sensi- ▸▸

▸ tive pension-reform issue. Mr Sarkozy seems ready for a fight on this and promises to continue with other reforms as well. Yet he is also showing signs of easing off. This week, he abandoned his plans to bring in a carbon tax.

As for the Socialists, described as "dead" only last year, they must take their resurrection a step at a time. Martine Aubry, the party leader since 2008, has clearly gained clout. She has proved that she is more than just a caretaker and can actually win elections. She stitched and held together a solid alliance with greens and communists. Yet the Socialists are their own worst enemies, and their squabbling could undo them. Ms Royal has her eye on the presidency, as does Dominique Strauss-Kahn, boss of the IMF. But history teaches caution. At the 2004 regional election, the Socialists swept the board—only for Ms Royal to fall flat in the presidential election three years later. ■

The crisis in Greece

Sound and fury

ATHENS

Gloom today may turn into anger tomorrow

NOT even Greece's diplomats will be spared the cuts in pay and allowances imposed by George Papandreou's Socialist government in its struggle to curb public spending. Just before this week's European Union summit in Brussels, staff stopped work for four hours to protest outside the neoclassical foreign ministry. "Altogether we're facing a 30% cut in income. That's really not acceptable," said the diplomats' well-dressed spokesman.

The mood gets gloomier with each round of cuts. Two rises in excise duties on fuel, alcohol and cigarettes in under three months have caused grumbling. On March 24th a bill arrived in parliament aimed at cracking down on tax evasion by Greek companies as well as the self-employed. Doctors, lawyers and taxi-drivers will all have to issue VAT receipts; electronic systems for cross-checking returns will be upgraded. High-earners will have to pay more income tax. Yet many doubt if the tax overhaul will produce anything like the €2.7 billion ($3.5 billion) of extra income the finance ministry wants without a thorough clean-out of the notoriously corrupt tax administration.

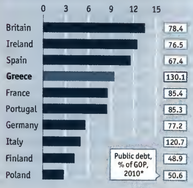
Pension reform is likely to make Greeks crosser still. The retirement age will rise from 58 (on average) to 65 for both men and women, bringing Greece into line with other EU countries. The number of female civil servants applying for early retirement has already jumped by 25% this year. The government wants to trim the public-sector payroll, but its most productive workers are often women in their 40s and 50s. "It's the most efficient female colleagues who are lining up to leave," says an official at the civil-service union.

The economy is likely to shrink this year by at least 2%, after a 2% contraction in 2009. That compares with the government's previous "worst-case" forecast of 0.8%. Unemployment is now close to 11%. Bank lending may rise this year by less than 3%. Among cash-strapped family-run companies, gloom is turning into pessimism. A survey published on March 22nd said that one-third of small-business owners in Athens and the surrounding region fear they may have to close down in the next three years.

The good news for Mr Papandreou is that, so far, his approval ratings have held up. More than two-thirds of Greeks accept that tough measures are necessary, say the polls. That makes it easier for the government to stick to the timetable agreed with Brussels for reforms. Mr Papandreou has pushed through three austerity plans in ▸▸

Fiscal sinners

Budget deficit, % of GDP, 2010*



Source: Economist Intelligence Unit *Forecast

Italy's elections and the media

Blacked out

ROME

How Silvio Berlusconi constrains political debate in the media

THE regional elections in Italy on March 28th and 29th will, as Silvio Berlusconi has himself conceded, be of national importance—a big test of the prime minister's popularity after a troubled 2009. On March 20th he called his supporters to a big rally in Rome, but the turnout was disappointing. The results of the elections may be tight.

So you might expect that the flagship channel of Italy's public-service broadcaster, RAI, would be offering blanket pre-election coverage on March 26th. Instead, its only programme will begin at 11.10pm and last for just five minutes. Prime time will be given over to two quiz shows and a talent contest. RAI's other two channels, along with the three private ones run by the prime minister's Mediaset group, will also be bereft of election comment and analysis.

Nothing better illustrates Mr Berlusconi's grip on Italy's media. In a country with low newspaper readership and internet penetration, the main source of political information is terrestrial television. With three of the four main private channels controlled by the prime minister and two of its three state-run channels toeing a government line, news bulletins are bland at best. The editor of RAI1's news, Augusto Minzolini, openly broadcasts pro-government editorials. When an English lawyer, David Mills, who was convicted of taking a bribe from Mr Berlusconi, escaped imprisonment because of the statute of limitations, RAI1's news said wrongly that he had been acquitted.

This makes political talk shows more important. Although equal-airtime legislation was introduced in 2000 to avoid bias, Italy's media watchdog, Agcom, decided last month that the best way of all to guarantee balance was to ban talk shows during the campaign. This decision might be dismissed as misplaced punctiliousness were it not for evidence that Agcom has been subject to pressure from Mr Berlusconi. Police looking into loan-sharking came across a conversation between the prime minister and an Agcom board member, in which Mr Berlusconi had allegedly demanded that it shut down "Annozero", a hostile talk show. The board member reportedly offered help from officials in preparing a formal complaint.

At the request of the fourth private terrestrial channel and of Rupert Murdoch's Sky satellite network, a court has overturned Agcom's decision. But neither Mediaset nor RAI has reinstated the talk shows. The daily *Corriere della Sera* is trying to fill the void by hiring a noted TV journalist to present a programme on its website. The team from "Annozero" is mounting a web-only show in Bologna. But the web is a poor substitute.

The blackout silenced Mr Berlusconi as well. Until March 23rd, that is, when he intervened by phone in a popular RAI breakfast TV programme and aired his views—without contradiction.

the past four months in response to prodding from the European Commission and from Greece's euro-area partners. Even the European Central Bank has praised its efforts to sort out the public finances.

Yet without a firmer offer of financial assistance from other euro-area countries and perhaps the IMF, the gain from belt-tightening measures could easily be swallowed in higher borrowing costs. Greece's debt may be on an unsustainable path whatever it does (see page 80). That is why the government has been losing patience with German dithering on support measures, and occasionally threatening to go to the IMF instead. If interest rates on its bonds remain at twice German levels, Greece could face a borrowing crunch next month—and the gloom could then turn into outright anger. ■

Spain's economic woes

The mañana syndrome

MADRID

The government is not doing enough to tackle Spain's economic problems

ON A small plot of land near Candeleda, in Ávila province, Antonio de la Cruz is planting tobacco. It is years since he grew anything. During Spain's decade-long boom, he worked on construction sites, which paid better. But building has ground to a halt. "I've got to do something," he says. He is lucky: few of Spain's 4.3m unemployed (almost 20% of the workforce) have bits of land to plough.

A morale-boosting advertising campaign, backed by 18 large banks and companies, tells glum Spaniards that their problems can be fixed "between us all". The opposition People's Party disagrees. This has to be fixed by whoever broke it, says its spokesman, Esteban González Pons. He means that the Socialist prime minister, José Luis Rodríguez Zapatero, should do the fixing—and that he is failing.

The list of things that need repair is extensive. Spain's structural faults were long hidden by a housing bubble and have been glaringly exposed now that it has burst. From unemployment and low productivity growth, and from troubled savings banks to creaky public finances, the problems are piling up. With the government unwilling to apply radical surgery, there are fears that Spain will fall further behind its neighbours. "The risk is that we will have a lost decade, like Portugal or Japan," says Lorenzo Bernaldo de Quirós, an economist at Freemarket International Consulting in Madrid.

Unemployment tops most people's worries. Faster growth is needed to bring it down. Yet Spain has been in recession for seven quarters; the government expects GDP to shrink again this year; and the IMF forecasts growth of less than 1% in 2011.

The public finances must also be fixed. Last year's deficit ballooned to over 11% of GDP. In January Elena Salgado, the finance minister, produced an outline of austerity measures that calmed market fears about Spanish debt. But two months later the plan still lacks detail—and has an obvious flaw. An optimistic Ms Salgado predicted growth of 3% in both 2012 and 2013, bringing added revenues to cut the deficit. Spain's European commissioner, Joaquín Almunia, has warned against the sin of over-optimism. Growth will not go over 2% until 2014, says Ángel Laborda, an economist at FUNCAS, the savings banks' foundation. He reckons that more tax rises and spending cuts are inevitable if the government is to hit its 3% deficit target by 2013.

Ms Salgado is already raising value-added tax, with the top rate going from 16% to 18% in July. Mr Zapatero says this will finance the unemployed. "We can pay unemployment benefits to half a million people," he said in a television interview. Yet higher taxes will also dampen consumer spending, sending growth lower still.

Deeper reforms to Spain's economy look unlikely. The Bank of Spain's governor, Miguel Ángel Fernández Ordóñez, is calling for reform of a rigid labour market that makes most employees too costly to fire but condemns a third of workers to unstable, unprotected temporary jobs. Yet the government has repeatedly delayed pension and labour reforms. Mr Zapatero's great goal is to conserve social peace. That means keeping trade unions happy, even if reforms (and growth) have to wait.

Some detect a whiff of cowardice. Mr Zapatero's determination to avoid general strikes is proof that he will never take a difficult decision, says Artur Mas, head of the Catalan Convergence and Union coalition. And because broad agreements on public-spending cuts lack detail, they also lack urgency. A recent austerity deal with regional governments, responsible for over a third of Spain's public spending, allows for two more months of haggling.

In the meantime Spain's financial sector is jibbing at reform plans. Some *cajas* (savings banks) are heavily exposed to construction and housing loans. Mr Ordóñez says a third of the 45 *cajas* need to disappear (by being absorbed by others). A €99 billion ($132 billion) rescue fund is producing only limited consolidation so far, with perhaps seven Catalan *cajas* merging into two. Local politicians, who have a big say in their *cajas*, do not want to lose power. The Bank of Spain must act urgently, says Luis Garicano of the London School of Economics. The system cannot improve so long as doomed entities are kept alive, says Miguel Martín, president of the Spanish Banking Association.

Zapatero contemplates the fiscal abyss

The delay in sorting out the *cajas* adds to the sense of drift. Most Spaniards do not see the economy improving any time soon. Faith in the political class is at rock bottom. The Spanish now rate politicians as a bigger problem than their old bugbear, terrorism. Mr Zapatero's Socialists are trailing in the polls—but an election is not due for two more years. ■

Turkey and Africa

Ottoman dreaming

KINSHASA AND YAOUNDE

The Turks have new ambitions for trade and influence in Africa

MBOMBO IBRAHIM MOUBARAK, an Islamic cleric who runs Cameroon's Islamic humanitarian-assistance programme, has a dream. "Turkey must reclaim its mantle as leader of the Islamic world," he said on March 17th, as Abdullah Gul became the first Turkish president to visit Cameroon and Congo. Mr Moubarak believes that Turkey's brand of moderate Islam, which embraces Western-style democracy and the free market, offers a model for Africa's Muslims. He sees nothing sinister about the mosques, *madrassas* and schools built, restored or run by Sunni Turks across the continent.

Mr Gul's African expedition was more about finding new markets than new converts, which helps to explain the presence of some 140 Turkish businessmen in his entourage. The economic crisis has hit Tur-

key's trade with the rest of Europe. So the "Anatolian tigers"—small-and medium-sized entrepreneurs from Turkey's conservative heartland—are eyeing opportunities in Africa. And Africans are responding with enthusiasm. In Yaoundé your correspondent was approached in the loo of a five-star hotel by a Cameroonian lady saying "I want to sell timber to Turkey."

The Turks in turn want to sell Africans a range of finished goods, from washing powder to jeans. Turkish contractors are angling to build airports, housing and dams. Turkish Airlines now has regular flights to Addis Ababa, Dakar, Johannesburg, Lagos and Nairobi. Mehmet Buyukeksi, president of Turkey's exporters' association, says that Turkish exports to Africa have leapt from $1.5 billion in 2001 to over $10 billion in 2009. "We believe in the future of Africa," he declares.

Turkey cannot hope to match up to the likes of China or India. Yet Mr Gul believes it has a competitive edge. "We have come here with a clean slate, with a humanist approach," he says. In fact Egypt, Libya, Algeria and Sudan were all once part of the Ottoman empire. But farther south Turkey is on virgin turf. Locals often have bitter memories of rapacious Western colonialists and Arab slave traders. This is another reason why Turkish Islam has such appeal—and can be so good for business.

Ebubekir Keskin, a 37-year-old Turkish businessman who settled in Douala, Cameroon, three years ago, swaps Turkish-made pasta for local timber. He says his business model is based on alliances with local Muslims. "Being Muslim helps big time, soon we will overtake the Italians," he boasts. His ambitions are bolstered by members of Turkey's largest Islamic fraternity, led by a moderate Muslim cleric, Fetullah Gulen, who lives in America. Gulenists now run 60 schools in 30 African countries. Staffed by locals and Turks alike, the schools are patronised by the offspring of elites lured by Western standards of education (if not mandatory Turkish-language classes).

One day Turkey would like political clout in Africa as well. Its decision to declare 2005 "the year of Africa" was linked to its ambitions for a seat on the UN Security Council. It duly got one, with all but one African country voting in its favour. It has opened or plans 12 new embassies in Africa. Young African diplomats are being trained in Ankara. Scholarships to Turkish universities were doled out during Mr Gul's latest trip.

Turkey's desire to join the European Union can sometimes complicate its African ambitions. Faced with EU howls, it had to withdraw a recent invitation to Sudan's president, Omar al-Bashir, who has been indicted by the International Criminal Court for war crimes in Darfur. Widespread abuses in other African countries that Turkey is wooing could yet cause further headaches.

Mr Gul is undaunted. "There are many people like us here, the Lebanese for example," he notes. He might have added Armenians and Greeks too. But many of these are descendants of Christians who were killed or deported as the Ottoman empire collapsed, and went on to be big traders in provincial African towns. Unlike their fellow Africans, their feelings for Turkey may not be warm. ■

Flying the Turkish flag in Africa

Constitutional change in Turkey

Reform or die

ISTANBUL

The government girds itself for a battle over constitutional reforms

A FRESH burst of reformist zeal, or a final assault on the secular establishment? Whichever is right, the constitutional changes proposed this week by Turkey's mildly Islamist Justice and Development (AK) government have raised tensions with its critics in the secular elite. The measures would further curb the powers of Turkey's once omnipotent generals (who wrote the present constitution after a military coup in 1980) and their allies in the judiciary. They include a law to allow civilian prosecutors to try would-be coup plotters. Just such a measure was recently quashed by the constitutional court at the behest of the opposition Republican People's Party (CHP).

A bastion of Turkey's secular establishment, the court (like the CHP) has the reflex instinct of opposing any moves to assert the authority of elected officials over generals. This may explain why many of the changes suggested by AK would overhaul the way in which judges are selected. If the package is approved, the Turkish president would choose most members of the constitutional court. The government would also gain some sway over the supreme board of judges and prosecutors, another secular stronghold that picks most court officials. Critics say that this would allow Islamists to infiltrate Turkey's court system.

Such claims would carry more weight if AK were dealing with one of its supporters' main grievances: the ban on Islamic-style headscarves in state universities and government offices. When AK tried to change this after being elected for a second term in 2007, the chief prosecutor, Abdurrahman Yalcinkaya, began proceedings to close the party on the ground that it wanted to introduce *sharia* law. In 2008 the constitutional court threw the case out, albeit by a single vote. Mr Yalcinkaya is said to be building a new case against AK. Not surprisingly, AK's constitutional reforms include a provision to require parliamentary blessing for the banning of any political party.

The AK prime minister, Recep Tayyip Erdogan, insists that the constitutional changes have no purpose other than to promote Turkish membership of the European Union. He is lobbying opposition parties, because constitutional reforms need a two-thirds majority in parliament, which AK lacks on its own. But all the opposition leaders have rejected his overtures. That may force Mr Erdogan to put the measures to a referendum instead. But this carries risks of its own: should voters say no, this would be cast as a vote against the AK government itself. No matter, say AK insiders. Polls put Mr Erdogan way ahead of his opponents, with AK still on 40% support. So long as the opposition blindly resists all constitutional and other reforms, they will remain in opposition.

Charlemagne | The myth of the periphery

Forget core against periphery in Europe: the true divide is north against south

THE "peripheral" economies of the European Union are all in trouble, it is said. So Europe's "core" economies, especially in the euro-area heartland, must decide how to help colleagues teetering on the edge of both bankruptcy and the map—without wrecking the budget discipline needed to make the euro work. This week's summit of EU leaders, which began after *The Economist* went to press, was due to be dominated by this debate, pitting Germany (the core of the core) against governments that believe a credible plan must be drawn up to help far-flung, spendthrift members of the club. The list starts with Greece. But there are worries ahead about Portugal, Spain and even Italy.

Talk of an ailing periphery has become so common in the EU that it takes a squint at a map to realise how odd (and revealing) it is. An outside observer might conclude that in the EU, a country's economic might (and its credit rating) correlates with its distance from Brussels and Frankfurt. Yet this is not so. Finland is a euro-area country a long way from both cities that can raise ten-year government debt more cheaply than such core countries as France and Belgium.

In practice, talk of peripheral Europe is, deep down, a way of saying something quite different. When journalists, officials and politicians first began to use the phrase, it was shorthand for southern countries with worrying public finances, plus Ireland, also on the edge of the European map. Recently, though, Ireland has become a pin-up country, praised by senior officials and politicians for a stoical embrace of austerity after its property bubble burst. "Peripheral" is now no longer a shorthand term, but a euphemism for "southern".

North-south divisions are hardly new in the EU. When the euro was planned in the 1990s many German politicians wanted a currency zone comprising only Germany, the Benelux countries and France. France wanted a bigger group, fearing that southern countries outside would devalue, as both Italy and Spain did in 1992-93, making French exports less competitive. But the Germans suspected France's southern push had other goals: a monetary union likelier to tolerate both greater fiscal laxity and more political meddling.

In truth, Europe's south is not a monolithic block. Charlemagne recently went to Portugal. Although it is under less pressure than Greece, Portugal's credit rating was downgraded this week. It has a big budget deficit and deep structural problems (more than half of Portuguese adults left school at the minimum leaving age). Portugal suffered a shock when ex-communist countries joined the EU and lured multinational firms that liked cheap labour. Against that, Portugal has done more to trim its public sector than Greece and Spain and more to reform its pensions than Italy, and recently froze welfare spending until 2013.

In Lisbon memories are fresh of how northerners were "surprised" when Spain, Italy and Portugal met entry conditions for the single currency. Antonio Vitorino, a minister at the time, recalls a Dutch colleague frostily saying: "well, now you've qualified for the euro, you don't need cohesion funds [ie, EU regional help] any more." Yet Portugal did not do its homework to prepare for euro entry, says Mr Vitorino. After qualifying for low German interest rates overnight, citizens entered a spiral of private debt. Nor did Portugal reform its labour markets. "We all knew from 1999 that there could be asymmetric shocks in the euro zone," says Mr Vitorino, later an EU justice commissioner. But Germany "refused to discuss" the strains that might be caused by differing levels of economic development.

Today's north-south divisions are sharper, more populist, and carry greater risks. It is no political mystery why the German chancellor, Angela Merkel, has taken such a hard line on a Greek bail-out and hinted that the worst-behaved countries should face expulsion from the euro. German voters are strongly opposed to paying for Greece to avoid default, and Germany's constitution also sets legal hurdles to any bail-out that might threaten the euro's stability.

German virtue against Greek vice

In politics arguments have special force when they are easy to grasp and reflect long-held prejudices. The German debate on Greece has been shaped by the fact that some Greeks can retire ten years earlier than Germans, and by the statistical fraud carried out by previous Greek governments to disguise their budget deficit. From this, it is but a short step to German headlines calling Greeks "swindlers in the euro zone" (triggering Greek headlines about Nazi crimes and gold-pinching in the second world war).

Such name-calling ignores the human complexity of Europe. Greece has been badly governed for years, with successive governments handing out jobs for life, early retirement and lucrative contracts. But such clientelism came about partly because the country was harshly ruled for many years. Socialist rulers expanded the public sector in the 1980s partly to bring leftist citizens back into the mainstream after decades of exclusion and repression by the right. Jobs for life were granted partly to stop new governments sacking their predecessor's favourites.

Such history matters. From the north, southerners handed jobs for life by political patrons look privileged. From the south, those public-sector workers feel more like victims, whose low-paid jobs are just compensation for past ills. (Portugal's public sector grew partly to absorb 800,000 citizens who arrived after its colonial empire collapsed in 1974.)

Europe is going to need more empathy if the euro is to hold together. The hard work of returning to true convergence will be impossible without voters' consent. As Europe faces that task, no economy, north or south, can be considered peripheral. ■

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Class and politics

The misinterpreted middle

Britain's teeming but invisible average earners will decide the coming election. Neither David Cameron nor Gordon Brown seems to understand them

IN THE early pages of "Unfinished Revolution", an inside account of New Labour published soon after it won power in 1997, Philip Gould, then the party's pollster, chronicles "the land that Labour forgot" in the 1980s. It is a kind of Everywhere, whose denizens are "neither privileged nor deprived, but...struggling to get by". Margaret Thatcher seduced these voters (see picture) by rewarding their aspirations to "improve their homes and their lives; to get gradually better cars, washing machines and televisions; to go on holiday in Spain rather than Bournemouth". The setting is Mr Gould's hometown of Woking, but it could be any new commuter conurbation or unfashionable suburb.

In America these people would be called what they plainly are: middle class. They are around the middle of the national income distribution. They have jobs of middling status, perhaps in retail or self-employed manual trades. Their nondescript semi-detached houses are neither in the inner cities (from which they, or their parents, often migrated) nor in the kind of suburbs conventionally described as "leafy" (to which they aspire to move).

In Britain, though, "middle class" has come to refer to people who are actually well off, in part, perhaps, because a small aristocracy notionally occupies the top spot socially. Middle-class professions are taken to include medicine, teaching and the law. One newspaper columnist thinks a typical middle-class family might have a "combined income of £100,000", or $150,000; in fact it is probably closer to £30,000. Rising school fees are supposed to be a middle-class worry, though only 7% of British schoolchildren are educated privately. And the term is just as misused in politics. Advocates of cutting inheritance tax say it punishes the middle classes; yet it is only charged on estates worth at least £325,000, fully £100,000 more than the price of the average home. The 40% rate of income tax is also said to affect them; in fact, it catches just 3.8m of Britain's 31.7m income-taxpayers.

There are many reasons why it matters that elites do not recognise the real middle class. One is their sheer weight of numbers. In 2007 half the population belonged to the socioeconomic categories C1 (lower-end white-collar workers) and C2 (skilled manual workers). The top two categories, A and B, accounted for 26%; the poorest two, D and E, for 24%. British society has morphed from a post-war pyramid, with a tiny elite, a somewhat larger middle class and a vast working class, into a diamond, where the middle is fattest.

The middle classes also matter because they are natural swing voters. Unlike the rich or the poor, it is not obvious whether their economic interests should dispose them to small or big government. Unlike the residents of great northern cities, or gilded areas of the south, middling suburbia has no tribal or historical link with either Labour or the Conservatives.

In the general election of October 1974, only 26% of the skilled working-class voted Tory, compared with 49% who voted Labour (see chart on next page). In 1979 as many voted for Mrs Thatcher (41%) as for Labour. Neither ABC1s (lumped together by pollsters) nor DEs swung to the Tories so dramatically. She then built up a lead in their affections before they began returning to Labour in the 1990s. Much is made of lessening class allegiance in voting since the war; of all social groups, the middle class has proved most volatile, and most likely to shop around for its politicians.

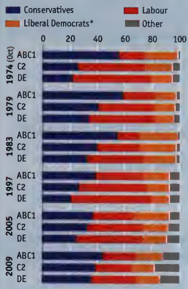
But the most important reason for recognising the real middle class is that it has had a worse time of it in recent decades than is generally recognised. True, the liberal economic reforms that began in the 1980s helped them in many ways. More became home-owners, accepting Mrs Thatcher's invitation to buy their houses from the state. Looser labour-market regulations made setting up a business easier. Deregulation in financial services meant they could aspire to work in the City of London, once a blue-blooded cocoon.

But a closer look suggests that they did not benefit unambiguously. Although incomes in the middle have not stagnated in recent decades, as in America, they have grown relatively slowly. Real median income increased by an average of 1.6% a year between 1979 to 1997, according to the Institute for Fiscal Studies, a think-tank, and then by 1.9% until 2007. This was lower than the rate at which the economy grew.

Much of this is down to the loss of middle-income jobs to technology or cheaper foreign labour. According to Maarten Goos and Alan Manning of the London School of Economics, the number of jobs in the top wage decile grew by almost 80% be- ▸▸

Middle-class spread

Voting intention by class, selected elections, %



Source: Ipsos MORI *Previously SDP/Liberals

tween 1979 and 1999. The next decile down saw roughly 25% growth, and the number of jobs in the lowest two deciles also increased. As employment polarised, jobs in the middle six deciles shrank, though there is some evidence that this trend of a "disappearing middle" has changed a bit under Labour.

The result is a middle class more vulnerable to hardship and insecurity than is often grasped. Research by the Department for Work and Pensions found that in the financial year 2006-07, 6% of households in the middle-income quintile could not afford to send their children swimming once a month, 9% had too few bedrooms to be able to put over-tens of the opposite sex in separate bedrooms and almost a quarter could not afford a week's family holiday away from home. A survey last year by the Trades Union Congress found that 38% of people in that same middle quintile were concerned about their job prospects, the same proportion as in the very bottom quintile.

Recognising the middle class is easier than winning their votes. David Cameron's Conservatives are struggling to match Lady Thatcher's rapport with them. His poshness, and that of many in his shadow and kitchen cabinets, is a handicap. (Nuances matter—Tony Blair was also a public-school boy but his parents grew up poor, so he understood aspirants better than politicians from old money.) His policies are skewed too. He has goodies for the rich, such as raising the threshold for inheritance tax, and for the poor, including a "pupil premium" which would pay schools better for educating deprived children. But he has no equivalent of Lady Thatcher's council-house policy for the middle class.

In this, Mr Cameron epitomises British elites: he understands his high-earning peers and feels a genuine *noblesse oblige* towards the poor, but the people in between seem somehow beyond his ken. This may be preferable to the outlook of American elites, who have a better sense of the middle but also tolerate a degree of poverty at the bottom that would not be accepted in western Europe. But it is still a problem.

Simply returning to a Thatcherite message would not electrify the middle class, despite what many on Tory right think. In 1979 its members felt held back by the state. Their views on political economy are now more ambiguous, as the state is less of a burden for them. Tax rises are still unpopular, as are handouts for those they regard as undeserving. But they also benefit from the welfare state more than before, through child benefit (increased by New Labour) and new tax credits.

That survey by the TUC last year was revealing. When asked whether responsibility for solving economic and social problems should lie mainly with government or with people, 62% in the middle quintile said government. No other quintile was as statist. They were also most likely to say that it is the responsibility of government to reduce inequalities in society. More than half said the government should redistribute money from the rich to the poor—as many as in the lower two quintiles. The romantic myth of rugged middle-class individualism is just that.

This seems good news for Labour, which won these voters back from the Tories by respecting their economic aspirations. If they now want social democracy, so much the better for a party of the left. But New Labour was also about addressing middle-class worries concerning crime and other social ills. Mr Blair's time as shadow home secretary in the early 1990s, during which he hardened Labour's line on law and order, was as important as Gordon Brown's as shadow chancellor.

Labour may soon have a personnel problem of its own when it comes to competing on this turf. When it was winning elections in 1997, 2001 and 2005, the backbone of the cabinet were Old Labour Right stalwarts, such as Jack Straw, David Blunkett and John Reid. They had modest backgrounds and spoke in plain language. They

Libel-law reform

Fairer but still costly

Reform of England's tough libel law is moving up the agenda

WHETHER or not lie detectors work sounds like a good subject for open and honest discussion. Unless English libel courts get in the way, that is. Francisco Lacerda, a Swedish professor of phonetics, believes that the science of analysing voices for signs of stress—and therefore deceit—is flawed. He published an article called "Charlatanry in Forensic Speech Science" in an academic journal. The publisher was then threatened with a libel action by an Israeli company that made devices that Mr Lacerda criticised.

The case (which has not come to court) is the latest to be cited by a coalition demanding changes in English libel law. Others include that of a British cardiologist, Peter Wilmshurst, who criticised the safety of an American-made medical device at an American conference—but is being sued, personally, in England. The law, critics say, unfairly protects reputation at the cost of the public interest. That hurts journalists, and scientists and anti-corruption campaigners. They also worry about "libel tourism": foreigners fighting cases in English courts that would be unsuccessful elsewhere.

On March 24th the justice secretary, Jack Straw, said Labour would introduce a bill reforming libel law after the election. It would create a statutory "public interest" defence and restrict libel tourism. Campaigners welcomed the promise, which is a defeat for some senior judges who have argued that nothing much is amiss. The Conservatives and Liberal Democrats also support reform.

A report issued on March 23rd, by a working group at the justice ministry, calls for changes too. But it also explains how hard it will be make them work. It is not true that the law in England currently allows no defence based on responsible journalism in the public interest. Thanks to some landmark judgments in recent years, that already (to some extent) exists. And courts have shown themselves willing to rule against claims by foreigners when no significant publication took place in England.

But winning such victories may be prohibitively costly. England's adversarial system of justice expects both sides to be represented; it does not encourage judges to be inquisitorial, as in continental Europe. Cutting costs would reduce the problem for small, poor news organisations that are being sued by tycoons (a notable example involves a Ukrainian website). But for scientists who are just trying to do their job a robust public-interest defence matters even more.

reminded metropolitan critics of the party's supposedly draconian policies that Labourism is not the same as liberalism, and that "their people" (the lower-to-middle classes) were the main victims of crime and uncontrolled immigration. Mr Brown and Mr Blair shared their instincts, if not their back-stories.

By contrast, those likely to shape Labour's future (perhaps the very near future, if a defeat at the coming general election is followed by a leadership contest) cannot claim a direct line to middle Britain. Mooted candidates include David Miliband, the foreign secretary, and his brother Ed, the energy secretary, scions of the north London *cognoscenti* with a tendency to speak in abstract nouns. Another is Harriet Harman, a near-aristocrat from the cultural left. Ed Balls, the schools secretary, is earthier and liked by trades unions but lacks political charm.

Intellectuals of the left are preparing now for a debate about their party's future. The Open Left project run by the Demos think-tank under the guidance of James Purnell (a former cabinet member) is one to watch. But much discourse is of a metropolitan bent. Labour thinkers deplore Mr Cameron's "broken society" narrative, but admit that it resonates with voters.

In politicians' defence, it is hard to craft policies for a class that includes nurses with a job for life in the NHS and salesmen whose incomes vary weekly. The interests of the rich and the poor are easier to grasp. Failing to command the votes of Britain's real middle class is excusable. Failing to recognise who they are, and to take their mixed fortunes seriously, is not. ■

The budget at a glance

Cram sheet

Our cheat's guide to the new budget

• **The economy** shrank by 6.2% during the recession. The Treasury predicts it will grow by 1.25% in 2010-11, rising to about 3.25% the year after. Borrowing will be £167 billion ($249 billion) this year—a record, but slightly down on the £178 billion originally forecast. Public debt will peak at 74.9% of GDP in 2014-15.

• Handouts to **business** were bitty but numerous. An investment bank will disburse £2 billion to low-carbon industries. Tax breaks on investment have doubled to £100,000 a year, and there will be a one-year cut in business rates targeted at small firms. A scheme that extends the grace period for small firms to pay tax will be extended for a year.

• Plenty of governmental leaning on the **banks**: Royal Bank of Scotland and Lloyds have been told to provide £41 billion in loans to small firms. A tax on bank transactions is in the works, provided there is international agreement. Banks will be forced to offer everyone with a fixed address a basic account.

• A mixed bag on **taxes.** First-time buyers are exempt from stamp duty on homes worth less than £250,000, up from £125,000, which will be paid for by a rise in duty on homes worth £1m or more. A one-off tax on bankers' bonuses has raised about £2 billion, much more than predicted. A clampdown on tax-dodging includes new information-sharing agreements with Belize, Dominica and Grenada.

• There are details on a planned £11 billion in **government savings.** Public-sector pay rises will be capped at 1% over the next two years, and 15,000 civil servants will be moved out of London to cheaper bits of the country.

• **The budget in a nutshell:** with an election imminent, it was even more of a political event than usual. Labour says: the recovery is too fragile to raise taxes or slash spending. The Tories say: Labour is running up mind-boggling debts. *The Economist* says: expect the really painful cuts to come after the election.

Taxing banks

There will be blood

A levy on banks for systemic risk is a budget and an election issue

FOR bankers, the war is not yet over. Britain's taxpayers are still sore. They blame the banks for pitching the country into crisis, and for hoarding their bail-out money rather than oiling the wheels of commerce by lending it.

Having a scapegoat is one thing. What to do with him is another. A one-off 50% supertax on banks paying discretionary bonuses of more than £25,000, announced last December, was meant to discourage the bonus culture. It didn't. In January President Obama announced a tax on American banks with assets of more than $50 billion (£34 billion) that aimed to claw back the cost of the crisis to the taxpayer—around $117 billion—over 12 years. Banks must pay 0.15% of all liabilities that are not covered by deposit insurance. Other countries, including Britain, are trying to co-ordinate a levy that would roughly match this tax. The IMF is expected to come out with a proposal in April.

Britain's three big political parties have espoused the idea, although only the Liberal Democrats have given details. They want a 10% tax on the profits of all British-registered banks (mutually owned building societies would be exempt), to be used to pay down the country's structural deficit. And on March 20th David Cameron, the Conservative leader, said that, if elected, his party would impose a bank levy no matter what other countries did. He later said that it would be lighter if Britain had to go it alone. The concern is that a unilateral levy might drive banks to other countries.

The Labour government intends to wait for an international agreement. But in the budget on March 24th it outlined how a "systemic-risk tax" might work: the proceeds should be for national governments to use, but in order to "minimise moral hazard" they should go into the general tax pot rather than a stand-alone fund.

José Manuel Barroso, president of the European Commission, thinks the levy should pay for a European, or even global, bail-out fund to meet a future crisis. The German government is working on a proposal to tax banks' risk-weighted assets. That could hit Deutsche Bank, its most active international bank, with a payment of about €2.2 billion (£2 billion).

It seems that willy-nilly some form of levy will come. The British Bankers Association (BBA), an industry lobby group, thinks none is needed. In a lengthy submission to the IMF's consultation on the subject, it accepts that losses incurred by banks should not be borne by the taxpayer. Yet in Britain, the BBA maintains, banks were forced to meet the direct costs of government help—though it admits there were indirect charges, such as the increased cost of state borrowing, which they did not.

Banks are already paying for the threat they pose to the system in the form of direct and indirect regulatory expense, says the group. And some of the costs should be attributed to failures in supervision. Touché. But the bruised British public is unlikely to be in the mood for such argument. ■

Bagehot | With a whimper

Alistair Darling's budget was a fittingly bathetic end to Labour's time in office

NEW Labour budgets once followed a predictable but entertaining script. Gordon Brown, chancellor of the exchequer for a decade, sprayed around impressive statistics and (after a brief period of self-restraint) cash at the public services. He often pulled a rabbit—a child trust fund, say, or a tax cut—out of his Treasury hat. Labour MPs whooped; journalists scoured the small print for the stealth taxes.

Some fancied the budget delivered by Alistair Darling on March 24th might offer its own kind of drama. It was the government's last chance to exploit the power of incumbency—ie, to bribe the voters—before the general election. Others hoped Mr Darling might put country before party, his legacy above popularity, and explain how Labour would right the public finances.

In the end Mr Darling didn't do much of anything. Those expecting pyrotechnics from the budget had overestimated it. And, in a way, the bathos was a fitting conclusion to Labour's stewardship of the economy, and to political debate over economic policy in the last few years. Overestimation, followed by let-down and disappointment, have formed the basic, recurring narrative.

Think back, for a moment, to Mr Brown's first budget, in July 1997. The new chancellor lambasted his predecessors who "deluded themselves into believing that growth, however unbalanced, was evidence of their success. I will not ignore the warning signs," he vowed. "Public finances must be sustainable," he admonished, otherwise "the poor, the elderly and those on fixed incomes...will suffer most." There were other now-ironic gems, such as "I will not allow house prices to get out of control" and "This is a government that keeps its promises on tax."

Everyone knows the punchline. A decade later, after Mr Brown finally moved into Number 10, it transpired that he had indeed deluded himself into thinking that unbalanced growth was proof of success; he had thoroughly ignored the warning signs. The economy shrank, the public finances collapsed and the deficit assumed record peacetime proportions. These are the central, inescapable and devastating facts of this week's budget—notwithstanding the news that borrowing was not quite as stratospheric as had been forecast. Mr Brown overestimated the robustness of the economy he oversaw. He overestimated the reliability of the dizzying tax revenues from finance and the housing market. He overestimated himself.

Initially David Cameron and George Osborne, the shadow chancellor, were underestimated by Labour, possibly for reasons of inverted snobbery. Yet they showed some mettle, over the past year, in making debt and the deficit a focus of national debate; they seemed to have broken free of the old orthodoxy ordaining that any politician hoping to get elected must promise eternal increases in public spending. Alas, Mr Cameron and Mr Osborne overestimated voters' appetite for straight talk about budget cuts; at least, that seems to be one inference they have drawn from their narrowing opinion-poll lead. While still noisily describing themselves as fiscal realists, when it comes to actual deficit-busting measures, they have gone disappointingly quiet.

As for Mr Darling himself: he has never been in much danger of being overestimated. But he has won a degree of esteem for his equanimity and good humour in the face of global financial turmoil, as well as the onslaught against him unleashed by his own prime minister's henchmen. ("The forces of hell", Mr Darling's term for the treatment meted out to him, will surely be one of the phrases by which Mr Brown's premiership is remembered, along with "no return to boom and bust" and "home secretary's husband put porn on expenses".) Mr Darling's growing political stature helped him, alongside his allies in the cabinet, to force Mr Brown to acknowledge the need for cuts.

The result is that, at least for the public finances, the once-stark difference between the two big parties turns out to have been overestimated. Both now say they will eliminate the "bulk" of the structural deficit over the next parliament, but little about how. The main belt-tightening measure Mr Darling specified—moving some civil servants out of London—was paltry. The Lib Dems rightly point out that the Labour-Tory row over when to start cutting is camouflage for the unresolved issue of what to cut.

Finita la commedia

But if he was shy over cuts, nor did Mr Darling offer many bribes. Rather, the budget epitomised the desiccated feel of politics in the no-money era. There was a temporary rise in the stamp-duty threshold to £250,000 ($373,000) for first-time buyers (evidently identified by Labour as a key electoral demographic). The Tories protested that they had announced that policy in 2007—though not Mr Darling's plan to pay for it by raising the rate for properties above £1m. There was some short-term help for small businesses, and, slightly bafflingly, some cash for universities, even as their funding is being squeezed. But there was nothing as dramatic as, say, an income-tax change. The biggest cheer on the Labour benches was raised by Mr Darling's impish announcement of a tax-information agreement with Belize—offshore abode of Lord Ashcroft, the Tories' controversial deputy chairman and donor.

So this is how it ends. New Labour was supposed to be a grand reconciliation of social justice and free-market economics. Mr Darling's speech, likely to be his government's last set-piece statement on the economy, offered a sad pastiche of that hybrid ambition. It threw a couple of wishbones at favourite causes. It paid lip service to prudence. Yet, apart from the still-daunting debt numbers, the highlight was a joke about a Tory "non-dom".

Judged against Labour budgets of yore, this one was a whimper. But it was also an apt finale to a deflating epoch. The rabbit has been stewed. The hat has been eaten. ■

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University rankings

Leagues apart

How tall is my ivory tower? University league tables give different answers

JUST as magpies adorn their nests with shiny trinkets, young people seeking to burnish their credentials love to scour league tables to spot the world's brightest universities. Time at such places, they hope, will stoke both brainpower and future earnings.

That creates a big global business. The OECD, a rich-country think-tank, reckons that more than 3m students are enrolled outside their country of citizenship. The number has trebled over the past 30 years. Most go to America, which attracted some 600,000 students in 2007, the latest year for which data are available. Britain, Germany, France and Australia are also popular destinations.

American institutions also shine in the rankings of university performance: exercises that are themselves of varying merits. The success comes despite growing grumbles about visa difficulties for foreign students, and rocketing costs. Harvard consistently tops a league table produced by Shanghai's Jiao Tong University. First published in 2003, this rates institutions according to the excellence of the research they produce.

In the most recent Shanghai table Europe fares remarkably poorly. It is certainly striking that from all of Europe only Oxford and Cambridge feature in the top 20. In the top 50 entries, Europe has only ten places (but 32 in the top 100). By contrast, fully 17 of the top 20 are American.

But many question the Jiao Tong rankings' methodology, which appears to favour those specialising in natural sciences over those with other merits. In any case, what research excellence actually means for most students is unclear. Catching a distant glimpse of a star professor is not the same as being taught by him. And the best researchers are not necessarily the best teachers. For many, the quality of teaching is what matters. Measuring it is far harder.

So in 2004 a rival appeared. It was compiled jointly by the *Times Higher Education Supplement*, a British periodical, and Quacquarelli Symonds, a provider of guides to higher education. This gave the main weight to outsiders' views—chiefly of other academics and of employers that recruit graduates. It included the staff-student ratio as a measure of teaching quality. Harvard still gained the top spot, but the number of British universities in the top 20 rose to twice that of the Jiao Tong rankings.

That attracted criticism too, not least for volatility. After a change in methodology in 2007, the London School of Economics, usually regarded as one of Britain's top five academies, crashed from 17th to 59th place. The LSE says crossly that the table does not capture excellence in social sciences.

Other rankings have mushroomed. One is based on how many links a university's website receives from other highly rated institutions. Another is based solely on the contents of a database of academic articles. *The Economist* publishes a ranking of MBA providers. The THES and its partner have now split: this year each will produce its own league table.

Plenty more such rankings are coming—including a heavyweight attempt by the European Union. It believes that the continent's higher-education institutions, the oldest in the world, are underrated. It has commissioned five European universities to compile tables which compare institutions that are similar in terms of their missions and structures. That should get around the oddity of trying to rank, say, a small mainly postgraduate outfit concentrating on economics against a big university that does brilliantly at teaching engineering to undergraduates. If a feasibility study goes well, the final results will be published next year.

Ending in tiers

Flawed or not, league tables have a big impact on the universities they measure. Do they deserve so much influence? Ellen Hazelkorn, who studies this at the Dublin Institute of Technology, says that the rankings are driven by their creators' objectives: the Chinese ones were intended to gain more state funding for university research; the European ones aim to give member countries greater status.

The confusion of aims risks creating perverse incentives. University bosses may manipulate pass marks to give the ap- ▸▸

pearance of success. Students game the system too. They can give spuriously flattering assessments of their own institution—thus raising its ranking and the value of the degrees it issues. Places with an undeservedly poor rating may find it hard to better themselves. However good a university's teaching may be, a lowly ranking carries a stigma, at least in some eyes. The Netherlands, for example, has a special visa programme for those holding masters degrees from universities that come in the top 150 in two international league tables.

The more that higher education looks merely like a market for an expensive product (true perhaps for MBAs but less so for classics courses), the more league tables matter. They give at least the impression of consumer choice. Students spending their own money (or their parents') seem to mind more about league-table rankings than those who receive state support.

Yet none of the league tables shows how well universities teach in practice. Later this year, the OECD will begin to test the abilities of final-year university students in different countries. That is tricky but not unprecedented. The OECD has, since 2000, measured how well 15-year-olds are educated in different countries by testing them on how well they can use what they have learned. That should add a welcome note of realism to the frenzied competition, especially at the top of the rankings. All that remains undone is a credible, rigorous ranking of league tables themselves. ■

Prenuptial agreements

For poorer

English courts used to ignore prenuptial agreements. Not any more

LONDON is the divorce capital of the world, for two reasons. It is home to many foreigners, often themselves in cross-border marriages. And it has a divorce law that—at least until now—sharply favours the poorer partner in a marriage (usually the woman). That can mean nasty surprises, particularly for rich foreign men whose wives issue divorce proceedings in London. English courts often choose to overrule clauses in prenuptial agreements, especially foreign ones, if they look unfair.

But a case now being heard by the Supreme Court in London is likely to give such agreements more clout. It concerns a German heiress, Katrin Radmacher. She used to be married to Nicolas Granatino, a Frenchman who dumped a lucrative career as a banker to become a humble Oxford don. When they married, he signed a prenuptial agreement (common in wealthy German families) agreeing that in the event of a divorce, he would get nothing from her.

But after the couple divorced in 2007, an English court awarded him a settlement of £5.9m ($8.9m). Citing the agreement, Ms Radmacher challenged that, and the Court of Appeal reduced it to £1m. In what will be a landmark ruling on English family law, Mr Granatino is now challenging this in the country's highest court. He argues that he did not know how rich Ms Radmacher really was (her fortune is over £54m and she stands to inherit a lot more) and that he did not have proper legal advice before signing the agreement.

Lawyers around the world are watching with interest—especially, notes James Stewart of Manches, a law firm, if they are involved in helping rich people manage their money. Such clients pay great attention to their tax and investment affairs, he points out, but they often neglect the "matrimonial" issues raised by residency in London. Rich Russians are particularly vulnerable to this: the usual "marital agreements" (in effect, prenuptials) that they conclude at home may carry little or no weight in London.

The Supreme Court's judgment is expected in a few months, probably around the time that the Law Commission, a body that tidies up the statute book, comes out with its own proposals for change. Both Labour and the Conservative Party have said they want to reform divorce law too.

Few doubt that prenuptial agreements are going to gain in importance. The question is how much. One issue is the level of independent legal advice. Kerstin Beyer, a dual-qualified German divorce lawyer practising in London, says that in Germany it is enough for a notary to draft the agreement on behalf of both parties. An English court (and most American ones) would expect each side to have its own lawyer. Another question is disclosure: did each side truly know the other's financial position?

A third—and probably the biggest—question is fairness. Courts in England and Wales see marriage as an institution, not a contract. They tend to look at needs first, and then equity. So a rich man may have to cough up lots of money (including from assets acquired before the marriage, or inherited) to house and support a wife, especially if she is looking after the children. English courts may also reckon that wifely efforts in childcare or home-making have stoked a husband's earning power, and give her a lifetime slice of it. A prenuptial agreement that disregards any of these three considerations is likely to count for less, or even nothing.

Most other European jurisdictions (and Scotland) take a flintier view: maintenance payments are scanty; only assets accumulated during the marriage are up for grabs. And prenuptial agreements are rigorously enforced. Most American states offer more generous terms for wives, but also enforce prenuptial agreements. A contract is a contract, says Marjory Fields, a former New York judge now practising as an international divorce lawyer. But American courts also have a high standard of fairness: she judged a case in which the groom made his bride sign the prenuptial on the way to the marriage ceremony; that invalidated it.

Though the European Commission launched an effort on March 24th to harmonise divorce law among ten like-minded countries (and it hopes other EU states will come on board), many international initiatives have become bogged down amid cultural and legal differences. Many lawyers doubt, for example, whether it is possible to produce a prenuptial agreement that would be globally recognised, let alone enforceable. And in many countries the whole idea of planning in advance for the failure of a marriage seems unromantic—or repellent. Yet in rich countries, the incidence is growing—not least because of grandparents, now often a family's richest members, who wish to ring-fence property in favour of grandchildren, keeping it away from grasping in-laws.

Increased use of prenuptial agreements sounds as though it means yet more lucrative work for lawyers. Yet just as divorce law in most countries now strongly encourages mediation rather than courtroom battles, new forms of collaborative drafting aim to take the sting out of premarital negotiations. It will still cost something—but, as Ms Fields notes: "If you need one, you can afford one." ■

Radmacher, richer than she seemed

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Pepsi gets a makeover

Taking the challenge

NEW YORK

The giant drinks-and-snacks firm attempts to wean itself off sugar, salt and fat

COCA-COLA once famously defined its market as "throat share", meaning its stake in the entire liquid intake of all humanity. Not to be outdone, Indra Nooyi, the boss of Coke's arch-rival, PepsiCo, wants her firm to be "seen as one of the defining companies of the first half of the 21st century", a "model of how to conduct business in the modern world." More specifically, she argues that Pepsi, which makes crisps (potato chips) and other fatty, salty snacks as well as sugary drinks, should be part of the solution, not the cause, of "one of the world's biggest public-health challenges, a challenge fundamentally linked to our industry: obesity."

To that end, on March 22nd she unveiled a series of targets to improve the healthiness of Pepsi's wares. By 2015 the firm aims to reduce the salt in some of its biggest brands by 25%; by 2020, it hopes to reduce the amount of added sugar in its drinks by 25% and the amount of saturated fat in certain snacks by 15%. Pepsi also recently announced that it would be removing all its sugary drinks from schools around the world by 2012.

Although Ms Nooyi talks about the need to "cherish" employees, and once wrote to the parents of her senior managers thanking them for bringing up such wonderful offspring, she rejects the notion that these goals are soft-headed or decorative. She argues that they are necessary to prevent food companies from going the way of tobacco firms, which are perennially held responsible by governments for the health problems associated with their products, and penalised accordingly. As it is, several countries in Europe and various localities in America have banned trans fats, a particularly unhealthy ingredient in much junk food. A bill introduced earlier this month in New York's state assembly proposes banning salt in restaurants. Michelle Obama, America's first lady, has launched a campaign against obesity among children.

In the 1990s virtually all of Pepsi's products were bad for you—or "fun for you", as the firm likes to put it. Under Ms Nooyi, who became boss in 2006, it has stepped up its diversification into products it calls "better for you" and "good for you", including fruit juices, nuts and porridge (oatmeal, to Americans). Ms Nooyi does not see this as a case of trading profits for virtue. Instead, she insists both are possible—an idea expressed in the firm's syrupy motto: "Performance with purpose."

There is no shortage of sceptics, both about the sincerity of Pepsi's social mission and, more recently, its performance, which was decidedly flat in 2009. Indeed, this week, at the firm's first meeting with investment analysts since 2006, in New York's Yankee Stadium, Ms Nooyi admitted to a series of disappointments, before promising that lessons had been learned and that "we won't make the same mistakes." As well as being hurt by the economic downturn, Pepsi suffered from a flawed financial hedging strategy that left it paying too much for commodities. And it has suffered from some recent marketing disasters, including a campaign for Tropicana fruit juice that is widely regarded as one of the worst brand makeovers since Coca-Cola launched New Coke.

Yet investors seem to be taking seriously Ms Nooyi's claim that Pepsi's future is bright. It helps that the firm has raised its dividend and announced a big share buyback. Investors also seem to be reappraising Pepsi's decision last year to acquire the two independent firms that bottle its drinks. The deal had received a tepid reception, not least because Coca-Cola had insisted that keeping syrup-making and bottling separate made sense. Now, however, Coca-Cola has decided to follow Pepsi's lead by acquiring its main bottler—a move Ms Nooyi describes as "vindication".

The hope is that integrating the bottling company into Pepsi will bring greater control over an increasingly diverse drinks portfolio, and promote cross-marketing between the food and drink divisions (not something that Coca-Cola's acquisition will help with much, as it does not own a large snack operation). Pepsi, which jointly markets several different brands, dubs the clout this gives it with retailers and customers "Power of One". The bottling acquisition should boost this tactic by ending the need to negotiate a division of the spoils on every big deal. When Wal-Mart calls asking for a joint promotion of, say, Pepsi and Doritos, as it did for the Super Bowl in February, Pepsi can "respond in 24 hours, instead of six weeks."

Ms Nooyi wants to take this idea fur- ▸▸

ther, with a strategy she snappily dubs "Power of Power of One". By that she means partnerships with other firms to cut the cost of procurement, or research and development. Pepsi has already signed a supplies and ad-purchasing deal with Anheuser-Busch, a big brewer.

In the long run, much will depend on the success of Pepsi's strategy to convince the public and regulators that it is on the side of reducing obesity, not creating it. This strategy will have several prongs, including reducing the amount of obviously unhealthy ingredients in its existing products, adding new healthier products to its portfolio, promoting healthier lifestyles and trying to point the finger of blame away from how many calories people consume to how few calories they burn. "Why aren't we going after computer and cable-TV companies for creating a sedentary lifestyle?" asks Ms Nooyi.

Pepsi's growing portfolio of "good for you" products now accounts for around $10 billion in revenues (nearly a fifth of the total). Ms Nooyi expects that figure to grow to $30 billion within ten years. The firm has been hiring an army of experts on health to work in its research and development business, to give credibility to its claim that it is applying science to creating products that are better for its customers. Mahmood Khan, a British-born doctor recruited to run Pepsi's R&D at the start of 2008, says he has been "pleasantly surprised by how rapidly this new health agenda has been embraced."

Pepsi already claims to be making significant progress in making its "fun-for-you products better for you" by voluntarily removing trans fats long before it was required to do so, and reducing the amount of sugar, fat and salt. There is now less salt in a packet of crisps, claims Dr Khan, than in a slice of white bread.

Quaker, which makes porridge, cereal, cereal bars and rice crackers, is Pepsi's leading healthy brand. Pepsi hopes to use its expertise in product design and packaging to make these goods more enticing, especially to children at breakfast time. It is already testing oatmeal drinks and biscuits, as well as new flavours of porridge. Quaker Oats packaging will also get a more contemporary look, although the black-hatted Quaker mascot will survive. "Our goal", says Ms Nooyi, in typically forthright style, "is to rewrite the rules of breakfast."

There is no doubting the seriousness of Ms Nooyi's drive to increase Pepsi's sales of healthy products. But it will not be easy to push them without undermining sales of its other, less wholesome wares or appearing to nanny its customers. Moreover, politicians and public-health campaigners may not regard selling more healthy products, while continuing to profit handsomely from unhealthy ones, as the best way to tackle obesity. ■

The strikes at British Airways

Maintaining altitude

BA's cabin staff appear to be fighting a losing battle

THE share price says it all. Since the end of last year, shares in strike-hit British Airways have risen in value by nearly a third (see chart). For all the apocalyptic headlines the airline is currently attracting, investors are increasingly confident that BA will win its battle with the cabin staff's union, Unite, and that when the smoke clears, little if any long-term damage will have been done to its resilient brand.

There are plenty of reasons why Willie Walsh, BA's combative boss, can look to the future with some confidence. First of all, the notion being peddled in much of the British media that customers who are quite sensibly avoiding BA now will never return is nonsense. The passengers that BA depends on most are those who regularly fly business class across the Atlantic. It is a pretty safe bet that most of them sympathise with the action management is taking to get the airline's out-of-kilter costs closer to those in the rest of the industry.

Furthermore, BA is so dominant on long-haul routes from London (and is soon to become even more so, thanks to its forthcoming merger with Iberia and the green light from the American authorities for its alliance with American Airlines) that for many passengers much of the time there is no alternative. BA's economy-class and short-haul customers living in south-east England will use the airline for the same reasons they do now—a wide choice of flights and convenience.

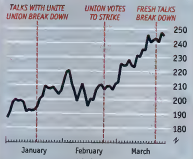
The botched opening of Heathrow's Terminal Five was meant to have permanently soured attitudes toward BA. But the slickness of the T5 experience has since become a draw. Passengers have short memories, it seems.

Critically, Mr Walsh has the support of his pilots, with whom he reached a separate deal last year. Geoff van Klaveren, an analyst with Deutsche Bank, points out that it takes a year to train a co-pilot, but cabin crew can be trained in 20 days. Significantly, on March 22nd, the last day of the first of two planned strikes, more cabin crew were reporting for duty than on March 20th, when it began. Lufthansa, whose flights have been severely disrupted by a dispute with its pilots, has found it harder than BA to maintain services. Despite the four-day strike due to start on March 27th, the airline expects over 70% of long-haul flights from Heathrow and all flights from Gatwick to get away.

The final point in Mr Walsh's favour is

Above the turbulence

British Airways share price, pence



Source: Thomson Reuters

that BA can afford to take the financial hit. It estimates that each day of strikes costs it about £7m ($11m). Against that it has a cash pile of nearly £1.5 billion. Whatever happens, it is on course to lose about £600m this financial year. Compared with the long-term value of getting new contracts with cabin staff as BA readies itself for the completion of the merger with Iberia, the cost of the strikes is well worth absorbing. Mr Walsh, it seems, holds all the cards. ■

Cricket booms in India

A big hit

DELHI

The Indian Premier League is raking in money but its teams are not

FOR cricket connoisseurs, the Indian Premier League, a six-week contest involving a shortened version of the game known as Twenty20, is horribly crass. With the onus on fast scoring, the world's best batsmen are encouraged to swipe at every ball, inducing a monotonous sort of thrill, not unlike what the IPL's European cheerleaders achieve with sparkly mini-skirts and pompoms. Cricket punters, needless to say, love it, and the IPL, which recently began its third six-week season, is booming. On March 21st two new IPL teams were sold at auction for a total of $703m (32 billion rupees), only slightly less than all eight existing teams sold for two years ago, when the IPL was launched.

For Lalit Modi, the IPL's boss, this showed it was "recession-proof". No kidding. Mr Modi has brought previously unimagined riches to a sport that was until recently managed amateurishly in India and elsewhere. Having sold the main broadcasting rights to the contest for 82 billion rupees, he has hawked it widely—striking recent deals with, among others, Google, to broadcast IPL matches on YouTube, and Britain's ITV. According to Brand Finance, a

consultancy, the IPL is worth over $4 billion, double its valuation of a year ago.

ITV must be pleased. In Britain, the birthplace of cricket, nearly half a million people watched the IPL's opening game on March 12th—easily more than peak viewership for an ongoing Test-match series between the English and Bangladeshi national teams, which admittedly is only being broadcast on a pay-TV channel.

Yet this is small beer by comparison with Indian audiences. According to TAM, India's television-ratings agency, 42m Indians watched the league's opening game, in which the Kolkata Knight Riders, a team part-owned by Shah Rukh Khan, a Bollywood star, biffed the Deccan Chargers. In its inaugural season, the IPL took four games to accumulate 50m viewers; this year it took only two.

For advertisers, the IPL's fans in India are an especially enticing crowd, with around 45% of them free-spending 15-35 year-olds. An early breakdown for the current season also shows a significant hike in the number of women watching, to around 38% of the total audience. These figures indicate an unparalleled opportunity to get into the heads of India's vast and growing middle class. By contrast, the opening match of the hockey world cup, the premier tournament for what is arguably India's second-favourite sport, drew only 8m viewers last month—though it was held in Delhi and pitted India's team against its Pakistani archrival.

Hence the hot bidding for the two new IPL teams, or "franchises". Sahara, a conglomerate that is also a leading sponsor of India's national cricket team, will pay $370m for a team it will set up in the western city of Pune; Rendez Vous Sports, a consortium, will pay $333m for a team in southern Kochi.

Even Mr Modi said he was surprised by these sums. But he pointed to an impressive business model. Franchise owners pay the IPL for their teams in ten annual instalments. In return they receive a big slice of its broadcast and sponsorship revenues. According to Mr Modi, the second of these payments already exceeds the first, two years ahead of schedule. That leaves players' salaries, capped at around $7.5m a year, as the owners' main expense, which they may try to recoup through ticket sales and team sponsorship. According to Mr Modi, "They should all be making money."

Most are not, however. To be profitable, according to Ness Wadia, co-owner of the lossmaking Kings XI Punjab team, it is "critical" to build a loyal fan-base. This was always an uncertain undertaking, given negligible interest in India's pre-existing state-based cricket contest. And it was made more difficult last year, when the tournament was abruptly shifted to South Africa for security reasons. To fill its ground in Mohali, Mr Wadia's team currently gives away around a quarter of the tickets. "I'm very gung-ho about the IPL," he says. "But we need to ensure the fundamentals are better inculcated."

The profitable Knight Riders, tirelessly promoted by Mr Khan, show that this can be done. For several big industrialists who own teams, meanwhile, the value of associating their firms with the IPL may compensate for their teams' losses. Most notably, Vijay Mallya's UB Group, India's biggest brewer, is forbidden by law to advertise its alcoholic beverages. But it has named its team, Royal Challengers Bangalore, after one of its brands of whisky. ■

703m for two

Yukos haunts Rosneft

A spectre of litigation

MOSCOW

Adverse court rulings are exhuming Russia's most infamous expropriation

REMEMBER Yukos, Russia's biggest oil firm, which was bankrupted by improbable tax claims and then dismembered in bogus auctions? The Russian government would rather that you did not. Although it has expunged Yukos from official registers, the firm's ghost is haunting the Kremlin and its state oil company, Rosneft, which swallowed Yukos's assets. In the past few weeks this ghost has been particularly active, making appearances in several European and American courts, demanding retribution and winning injunctions against Rosneft. Earlier this month an English court froze Rosneft's local assets in a case brought by Yukos Capital, an offshore affiliate of Yukos. A week later a similar freezing order was imposed by a court in Ireland.

This is part of an effort by Yukos's former managers to enforce an earlier Dutch court ruling that Rosneft should repay a loan of nearly $400m (plus interest and penalties), which it had acquired together with Yukos's main production assets. The loan dates to 2004, when the Russian authorities simultaneously piled up billions of dollars worth of tax claims on Yukos and froze its assets and bank accounts, making it impossible for the oil company to make any tax payments.

To shore up Yuganskneftegaz, its main production unit, Yukos arranged for a loan from one of its offshore affiliates, Yukos Capital. However, the government soon seized Yuganskneftegaz and auctioned it off to a front company called Baikal-FinanceGroup, which had been registered two weeks earlier at the address of a vodka bar in the provincial Russian town of Tver. A few days later Yuganskneftegaz ended up in Rosneft's hands. But Rosneft refused to repay Yukos Capital.

Remarkably, a commercial arbitration court in Moscow ruled in Yukos's favour, telling Rosneft to repay the loan. This decision was soon overturned but it gave Yukos Capital a chance to take its case to a Dutch court which also ordered Rosneft to pay up. When Rosneft refused, Yukos Capital asked the courts in Britain, Ireland and the state of New York to oblige it.

On March 17th the court in New York said that unless Rosneft had assets in the state, the case was outside its jurisdiction. (Yukos Capital was given 60 days to find such assets). But in England and in Ireland the freezing orders remain in place, at least for now. In a statement, Rosneft said the ▸▸

There is a ghost in the machine

British court order was groundless and it was taking all necessary measures to protect its interests.

The injunctions, which stop Rosneft from making payments from its local accounts, have put its oil traders and its creditors into a spin. They put Rosneft into technical default on loans from foreign banks which are secured by sale contracts between Rosneft and its customers. As Russia's largest oil company, it is certainly good for the money: the disputed sum represents just 10% of last year's profit. But it is the first time that Rosneft has been materially affected by its controversial acquisition of Yukos's assets.

The timing is particularly important given a $98 billion claim made in the European Court of Human Rights against Russia by Yukos before its destruction. Despite Russia's protests that Yukos no longer exists, the court accepted the case; a judgment is pending. In its defence, Russia argued that "the integrity, professionalism and independence" of Russian courts has not been challenged. But the European Court, which regularly overturns Russian legal judgments, may have a different view. If it finds in Yukos's favour, the shareholders could seek enforcement in any court in Europe.

Mikhail Khodorkovsky, Yukos's former owner, already serving an eight-year sentence for tax evasion, is now on trial for stealing oil as well. According to a recent poll, 41% of Russians believe that the government is putting pressure on the courts to secure a guilty verdict, whereas only 20% think otherwise.

The Kremlin has tried to portray Mr Khodorkovsky as a blood-soaked gangster and Yukos's destruction as a noble act on behalf of Russia's defrauded taxpayers. In a recent phone-in session open to the public, Vladimir Putin, Russia's prime minister, in effect accused Mr Khodorkovsky of murder, diverted responsibility for Yukos's bankruptcy to foreign banks and took pride in returning to the Russian people the money he says was stolen from them.

But few Russians seem to subscribe to that version of events. According to the same poll, only 7% of respondents believe that the destruction of Yukos has benefited the people, whereas 63% believe it was orchestrated in the interests of a small group of bureaucrats and businessmen with close ties to the Kremlin. The thought that some foreign courts might share that view must truly haunt Russia's rulers. ■

Outsourcing to Africa

The world economy calls

NAIROBI

Will improved communications attract call centres to Africa?

THE arrival of three international fibre-optic cables in Kenya in the past six months, the most recent this week, has sparked hopes of an information-technology boom. The Kenyan government reckons that business-process outsourcing (BPO) can provide work for the country's many unemployed graduates. As established outsourcing companies in India take on ever more complex and lucrative work, firms elsewhere spy an opportunity at the lower end of the BPO market, in prosaic jobs such as operating call centres and keying in data. Can Kenya win some of that business?

Four undersea cables will have made landfall in east Africa by the end of the year, enormously increasing the availability and reducing the cost of telecoms links with the rest of the world. Kenya also boasts a decent workforce: educated, hard-working, closer to customers in Europe and America than Asian call-centre workers, and, some say, more comprehensible too. High unemployment should help limit turnover of workers—a big headache for outsourcing firms elsewhere. One of the government's advisers, Gilda Odera, who runs a school to train call-centre employees, says warm customer service will also give Kenya an edge: "It's the way Kenyans deal with people, the tone, the manner."

But a smile and a cable are not enough in the cut-throat BPO business. Margins are slim; customers are fickle. "It's not plug and play. The operational costs and political risks are significant," says Andrea Bohnstedt, the editor of *Ratio*, a Nairobi business journal. "Connectivity is not a source of celebration just yet," agrees Bobby Varanasi, a consultant in the field.

Would-be investors say Kenya's tax code is unfriendly and, given the complete lack of public services, poor value. Crime is rife and electricity is patchy. The extra cost of paying for private security and backup generators can upend a business model. Some expect widespread violence in the run-up to elections next year. High costs and jammed roads make Nairobi an expensive place to build a giant call centre. Setting up further away from the capital would be cheaper, but a proposed high-tech city has stalled.

At the moment only 8,000 Kenyans work in BPO. Local banks and insurance companies, which are in growing need of their own call centres, guarantee some growth. But the government is much more ambitious: it reckons it can create 120,000 BPO jobs by 2020. The first step, officials argue, is to encourage consolidation among the country's many small call centres, with less than 100 seats. The economies of scale of giant centres of 5,000-10,000 seats, it is hoped, will minimise the disadvantages of doing business in the country.

Other African countries have similar ambitions. Ghana has also identified BPO as a pillar of future development. It wants to create 40,000 jobs by 2015, with a longer-term goal of earning $1 billion a year from the industry. It, too, is talking of technology parks across the country. But as in Kenya, many Ghanaians complain that their government's technocratic talk is not matched by action.

If BPO does blossom in Africa, there could be many positive repercussions. Call centres could train lots of managers, who could then apply their experience to other industries. In this way, say boosters, call centres could serve as incubators of local business talent—provided, of course, that the power stays on. ■

America's biofuel muddle

Coming up empty

CHICAGO

America will have trouble meeting its ambitious goals for biofuels

THE renewable-fuel standard released in February by America's Environmental Protection Agency (EPA) paints an ambitious picture of biofuels' future. It wants the amount of the stuff used as transport fuel to climb from 13 billion gallons (49 billion litres) in 2010 to 36 billion gallons in 2022, requiring by far the largest part of that increase to come from various advanced biofuels, rather than ethanol made from corn (maize). But although the future looks exciting, the present is rather grim. The EPA has been forced to slash its 2010 mandate for the most widely touted of the non-corn biofuels, cellulosic ethanol, from 100m gallons to just 6.5m, less than a thousandth of the 11 billion gallons produced from corn in 2009.

The fact that corn-ethanol production has continued to grow, despite the failure of a number of firms in late 2008 and early 2009, points to the efficacy of the various protections and subsidies it enjoys (falling maize prices helped too), though it says nothing about their efficiency or wisdom. Ethanol, which is used mainly as an additive to petrol, is not a particularly good fuel: it offers only about two-thirds as much energy as petrol and can corrode pipelines and car engines. By 2014 or earlier, ethanol production is expected to reach 10% of America's total fuel demand, and thus to hit a "blend wall", since the EPA does not at present allow blends of more than 10% for mainstream use.

Even as producers have urged the EPA to lift this bar, it has challenged them to move beyond corn and make ethanol from cellulose, the abundant, inedible portion of most crops. Using inedible inputs avoids fights about diverting food crops for fuel, and frees the industry from reliance on a single commodity. Despite ample investment, however, production costs remain high and commercialisation elusive. Since 2007 one company, Range Fuels, has received more than $150m in federal grants and guarantees for a large cellulosic-ethanol plant, but has yet to produce any. Still, it and others are gamely pushing ahead. A boost came last month, when Novozymes and Danisco, two Danish firms, unveiled new, cheaper enzymes which are needed to break down cellulose.

Even if cellulosic ethanol were to get cheaper, though, it would still be ethanol, a poor fuel. The alternative is to produce something better, such as an advanced biodiesel. According to Lux Research, based in Boston, venture capitalists invested $208m in algae technologies with this sort of thing in mind during 2008, six times as much as they spent in 2007. But building vast pools for algae and turning them into fuel remains tremendously expensive. Solazyme, a Californian firm, is a promising anomaly, using algae to make fuel from sugars in dark industrial vats rather than pools. Such strategies may work, but have yet to be scaled up. Solazyme, tellingly, has developed other sources of revenue.

America's government is doling out grants and loan guarantees, and oil companies are investing, too. Solazyme has a partnership with Chevron. Valero, America's biggest oil refiner, has bought up troubled ethanol plants and invested in firms that use plant material, algae and rubbish to produce fuel. BP's broad-based portfolio includes investments in Brazilian sugar-cane ethanol, cellulosic ethanol and a partnership with DuPont to produce biobutanol. "It still feels like the final bets have not been made," explains Phil New, the head of BP Biofuels. ■

Video games in the recession

Still playing

Despite a dip in sales, some still believe gaming is recession-proof

MANY video games feature an invincibility power-up that makes the player impervious to damage, at least for a while. As the economic crisis hit in late 2008, some said the same about the industry itself. The theory went that sales of video games, which had been strong in 2008, would also be strong in 2009, because games are a relatively cheap form of entertainment that let people escape from gloomy economic reality.

At first glance the sales figures seem to debunk the idea that video games are recession-proof. In June 2009, for example, sales of games in America were 31% lower than in June 2008, according to NPD, a market-research firm. In July sales were down 26%, the fifth successive monthly decline. But the year ended with a record-breaking December, as people bought consoles and games for Christmas. Globally, says Piers Harding-Rolls of Screen Digest, a consultancy, sales of games were down by 6.3% in 2009. The decline was biggest in America (9.3%) and smaller in Europe (3.5%) and Japan (2%). The number of Nintendo Wii and Microsoft Xbox 360 consoles sold was flat in 2009; sales of Sony's PlayStation 3 were up by 22% after a price cut.

Recession? What recession?

In some respects, this stumble reflects gaming's new popularity. When it was less of a mainstream activity it was not so connected to the wider economic cycle. The success of the family-friendly Wii has broadened gaming's appeal, but the new players it has attracted are less avid gamers who are more likely to cut back in hard times. During 2009 more people turned to mobile, web-based or second-hand games, says Mr Harding-Rolls.

Another way of looking at things, however, is to say that spending on gaming is driven by big hits, and that the slight decline in 2009 reflects creative rather than economic weakness. Entertainment industries always have their ups and downs, says Shigeru Miyamoto, the creative force behind many of Nintendo's biggest games. There was an unusually large number of hits in 2008, which boosted sales, and fewer big releases in 2009 until late in the year, which may explain the weak mid-year sales. The biggest hit was "Modern Warfare 2", released in November, which became the fastest-selling game in history, selling 7m copies worldwide on its first day. The top 20 games took a larger share of sales in 2009 than in 2008, which shows that the games industry, like the film industry, is becoming increasingly polarised between hits and misses. Hence the hit-and-miss results of the big publishers of video games.

Overall, says Mr Miyamoto, 2009's crop of games may just have been less compelling. "We were not able to produce fun-enough products," he says. That highlights the importance of continued innovation, he says—but it leaves unanswered the question of whether gaming is indeed recession-proof.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Schumpeter | The health-care squeeze

Business is right to be scared by the costs of Obamacare

"IT MAY not happen in my lifetime," Bill Clinton joked about Barack Obama's mammoth health-care bill a few days ago, "or Dick Cheney's, but hopefully by Easter." The joke proved prescient: Congress passed the bill the very next day and the president signed it on March 23rd.

It is undoubtedly a momentous achievement—the biggest change in America's welfare state since the 1960s and a determined attempt to bring health-care coverage to the country's 46m uninsured. But amid all the celebration it is worth asking a prosaic question. What does health-care reform mean for the source of the country's prosperity—business?

The answer to the question is not particularly edifying, though not for the reason that the Republicans would have us believe, with their apocalyptic warnings about "nationalisation", "socialisation" and "death panels". The most striking thing about Obamacare is not what it does, but what it fails to do.

Obamacare has taken the most idiosyncratic feature of American health care—the fact that the onus for providing health insurance falls first and foremost on companies rather than on individuals or the government—and set it in concrete. Companies with more than 50 employees will now be legally obliged to provide health insurance for their workers or else face fines.

Critics from both the right and the left have long argued that putting business at the heart of the health-care system is not a must but a bug. Left-wingers point out that employer-provided health care fails to control costs while leaving the government with a huge bill (Uncle Sam pays about half the cost of health care). Conservatives argue that costs would come down if individuals rather than companies were responsible for their own insurance. But Mr Obama insisted from the first that Americans who liked their existing cover would be able to keep it.

America is the only rich country that makes use of this halfway house of a system. It is an historical accident: employers began offering health insurance during the second world war as a way of attracting workers at a time when wages were fixed by the government. It became ever more elaborate and expensive during the post-war boom when big companies ruled the roost and when international competition was muted. Mighty unions added new features to their "Cadillac plans" with the same enthusiasm that Detroit added tail fins to real Cadillacs.

Today that world has vanished: global competition has intensified dramatically, the life expectancy of companies has shrunk, and General Motors complains that providing health care adds $1,500-2,000 to the cost of every car it produces in America. The system seems designed to inflate costs. Employees feel no compunction about undergoing expensive treatments, since the company pays. The fact that employer-provided insurance is untaxed blunts employers' incentives to control costs.

Researchers at the RAND Corporation have made a brave attempt to gauge the impact of America's health-care system on business. They analysed the performance of 38 industries over the 19 years after 1986. They also compared the performance of America's industries with their Canadian equivalents to make sure that they were not simply measuring global trends. They found that industries with a high proportion of workers enrolled in company-provided health-care schemes grew more slowly than those with a lower proportion.

From Main Street's point of view the Obama administration has done too little to control the costs of this flawed system. True, the non-partisan Congressional Budget Office estimates that the reform will leave the federal budget deficit $143 billion lower in 2020 than it would otherwise have been. The administration has also talked endlessly about "bending the cost curve downward". But the $143 billion estimate is based on the fairy-tale assumption that Congress will not increase the level of reimbursement it pays to doctors for Medicaid. And almost all of the curve-bending measures have been abandoned in the fight to pass the bill.

The most reasonable assumption for Main Street is that health-care costs will either continue to grow at the same pace as for the past decade—or accelerate. This is a looming disaster for American business. The proportion of GDP devoted to health care has grown from 5% in 1962 to 16% today. Rising health-care costs appear to have suppressed wages, as firms seek to make up for the expense. America spends 53% more per head than the next most profligate country and almost two-and-a-half times the rich-country average. With health-care costs rising much faster than general inflation and 500,000 baby-boomers now becoming eligible for Medicaid every day, health-care spending is likely to hit 20% of GDP by 2017 and 25% by 2025.

Small consolation

The health-care reform is not without its merits from business's perspective. The administration has tried hard to lighten the burden on small businesses, the engine of American job-creation. The bill exempts companies with fewer than 50 employees from the obligation to provide health insurance. It also creates insurance exchanges that allow small companies to buy insurance at a discount (because the clubs pool risks and administrative costs). But even such sensible changes hardly make up for the bill's failure to control costs. The share of three- to nine-person companies offering health insurance declined from 58% to 49% between 2002 and 2008 for the simple reason that it was too expensive.

The Republicans are promising to "repeal and replace" the bill. But a glance at the history of big welfare reforms demonstrates two things. The first is that new entitlements are almost impossible to repeal. The second is that overhauls of something as complicated as America's health-care system only come once in a generation. Harried business people will be dealing with the consequences of Obamacare for years to come. ■

Small island for sale

The takeover of Cadbury by Kraft seems to symbolise a hollowing-out of corporate Britain. The truth is rather more complicated

THE Thames Valley provides two contrasting examples of what happens when foreign companies buy British ones. Any day now the Scottish & Newcastle (S&N) brewery beside the M4 motorway at Reading will brew its last barrel. It opened only in 1980, the successor of William Blackall Simonds's 18th-century brewhouse in the town centre; its closure was announced two years ago, weeks after S&N was bought by Carlsberg, of Denmark, and Heineken, of the Netherlands, and carved up between them. There's little of Scotland, Newcastle or Berkshire left in what is now Heineken UK, a subsidiary of a Dutch lager-maker. Heads of departments such as marketing and product development are now in Amsterdam.

About 40km (25 miles) to the north, the BMW MINI factory in Oxford makes more than 200,000 cars a year, assembled with engines and body panels from sister factories in Birmingham and Swindon. MINI is a survivor of BMW's otherwise failed attempt to turn around Britain's ailing Rover group in the 1990s. Whereas the original Mini sold in large numbers but was an underpriced lossmaker, foreign ownership and capital have made the new version a global commercial success. Four out of five cars made in Oxford are exported; one in six BMWs sold is a MINI. The other surviving bit of Rover, Jaguar Land Rover, is on its third foreign owner—Tata Motors, of India—after Ford failed to turn it round. Tata's first move was to proclaim a ten-year plan to develop the two British brands; their outlook is at last looking brighter.

Britons these days are more likely to be found crying into their beer than celebrating successes like MINI. Cadbury, a venerable chocolate-maker, is just the latest household name to be swallowed by foreigners after a hostile takeover bid. Its recent purchase by Kraft Foods, an American company, has come to illustrate a complex set of anxieties: that Britain will lose jobs and skills, and that whereas British firms are open to takeover, their foreign predators are often protected against becoming prey themselves. There is something to these worries, but it is far from clear that Britain is a net loser. Purchases go both ways—and many British firms have found new strength under foreign owners.

An open and open case

For 30 years the consensus has been that Britain has more to gain than to lose from its open embrace of globalisation. It has welcomed the presence of foreign investors, by and large, as a vote of confidence in the country's business climate. British companies have also been eager purchasers abroad: this month Prudential, an insurer, agreed to pay $35.5 billion for the Asian assets of once-mighty American International Group. Repatriated earnings have flowed into British pension funds.

Britain has enjoyed a strong inflow of foreign direct investment. It has consistently attracted more than any other European country. A report on British manufacturing for Policy Exchange, a centre-right think-tank, notes that the openness of the economy "makes Britain a magnet for foreign companies looking for acquisitions on which they can build their manufacturing operations" for Britain and elsewhere. According to Dealogic, a financial-information firm, foreigners have spent $1 trillion on acquiring 5,400 British companies in the past decade. The British have spent less on foreign firms, $750 billion, but have snapped up a larger number, just over 6,000 (see chart 1 on the next page).

Now Britons aren't so sure that they have got a good deal. Their most basic anxiety is that foreign ownership will mean factory closures and job losses. As head offices close, power shifts abroad and Britain risks becoming a "branch factory" economy. When companies need to cut capacity, they will chop factories far from home first. Renault shut its Belgian factory in the late 1990s, rather than close one in France; Peugeot closed its British one a few years ago for the same reason. Three years after Corus, an Anglo-Dutch steelmaker, was taken over by India's Tata Steel, its complex at Redcar, on Teesside, is being mothballed. Kraft's purchase of Cadbury has also touched this nerve. Cadbury had intended to close its factory at Keynsham, near Bristol; Kraft said during the takeover ▸▸

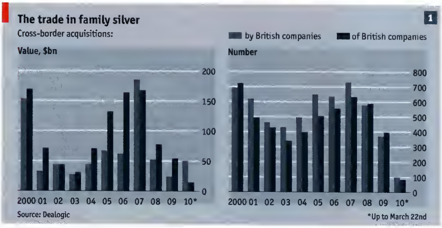
battle that it would keep the plant open, but then changed its mind.

The worry is not just about the quantity of jobs but also about their quality. The moan is that high-value head-office jobs and R&D skills will drift abroad. Cadbury's true expertise, for example, is not in making chocolate but in running a fast-moving consumer-goods company in global markets. As its head office in Uxbridge yields to Kraft's in Illinois, that British knowledge will be dissipated. Talented Britons may have to search for work abroad if there are fewer outlets for their skills at home. As the pool of know-how dries up, Britain will in turn become less attractive to foreign businesses seeking to do anything more complicated than basic work or serving the local market.

From time to time other countries are gripped by panic about foreigners taking over: in the 1950s Japan put in place barriers to stop American multinationals taking over its emerging industries; in the 1980s America worried that Japanese corporations were taking over Hollywood and prime Manhattan property. More recently Germany fretted that a swarm of (largely American) "locusts" was devouring its *Mittelstand*, the private companies behind its export success. A French prime minister even declared that Danone, a yogurt-maker, was in a strategic industry when an American rival came sniffing.

Britain has hitherto been more relaxed. This shows above all in its open market for corporate control. In America "poison pill" defences are still legal, and many states have laws that prevent local companies being bought by foreigners. In addition, points out Colin Mayer, the dean of Saïd Business School at Oxford University, "staggered" boards with fixed, differing terms mean it can take five years for a predator company to purge the board. By comparison, he notes that 90% of directors of purchased British firms are out of office within a year, leaving the new owners a free hand. Both the chairman and the chief executive of Cadbury were out within a few days of Kraft's takeover.

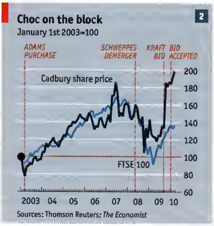
Most of the continental European companies that buy British firms are themselves protected from hostile takeover. Listed firms frequently have big, stable family shareholdings, bolstered by enhanced voting rights that enable families to retain control even when they are in a minority. The use of foundations and trusts of various types also helps shelter companies from hostile bids, as do state holdings, notably in France. All the more galling, then, for Britons to see such stalwart names as Cadbury, Rowntree and Terry's—to name only the chocolate-makers—fall to foreigners once the families were no longer in control. British business families can be eclipsed rapidly because shareholdings can quickly become widely dispersed. Mr Mayer believes that somehow the British have lost the secret of keeping family firms going as such for more than two generations. The biggest loss to the business, he believes, is the disappearance of a long-term vision, with the emphasis switching to short-term financial results.



Britain's imperial heritage left it with a disproportionate number of international companies and brands. These firms seem to have run out of energy to play the game of worldwide consolidation that accompanies globalisation of markets. Perhaps this timidity stems from the intense scrutiny of their widely held shares, making them leery about paying too much for foreign acquisitions. At the same time, in a globalised world, British firms with broad international reach are attractive partners to foreigners with money to spend.

Cadbury's soft centre

The takeover of Cadbury is a good example of Britain's open capital market in action. Cadbury was the world's second-largest confectionery company, behind Mars/Wrigley, an American group. It was a foreign shopper itself, having bought the Adams gum business in America from Warner Lambert, a pharmaceutical firm, in 2003. The confectionery market consists of chocolate, candy and gum, of which gum is the biggest part—still with huge growth potential as products become more varied. Although Cadbury's sales growth rose to 6% a year with that purchase, investors seemed unconvinced of its merits. The share-price performance was unexceptional (see chart 2). A salmonella scare in 2006 led to a widespread product recall in Britain. Cadbury demerged its Schweppes drinks business, but shareholders were unsettled by the time it took. It was completed in May 2008, in the teeth of the rising financial-market storm.



By late 2008 Cadbury shares were trading at less than £5 ($8.50) and most of the big institutional shareholders had bailed out. American investors showed more warmth than British ones towards Cadbury and the demerger. When Kraft launched its bid in September last year 49% of the shares were in the hands of North American investors, with British funds holding only 28%. This compares with an average British-held stake of 47% and a North American one of 23% for companies in the FTSE 100. As Roger Carr, Cadbury's chairman from 2008 until the sale to Kraft, points out, "Cadbury was unloved and unwanted by the UK investment community." Nor was it a particularly British firm. About 80% of Cadbury's business and over 85% of its employees were already outside Britain.

Even before the actual bid, when Kraft was first signalling its interest, Cadbury shares started to rise markedly. This changed the share register: North American investors went down from 49% to 27% as funds cashed in. Meanwhile, short-term traders such as hedge funds went from holding 5% (about average for a leading British company) to 31%. The battle became a matter only of the price that the Cadbury board could squeeze out of Kraft. It eventually recommended acceptance to its shareholders when Kraft offered £8.50 a share—50% more than the price when the first offer was made on September 4th.

In a lecture at the Saïd school in February, Mr Carr voiced his concern about the unfairness of Britain's open system. Mr Carr—who made his name building Wil-

liams, a conglomerate, through aggressive takeovers—focused on the way the war of words over a first approach and before a formal hostile bid (a "bear hug") served to destabilise the share register.

Mr Mayer is blunter. With short-term funds piling in, he notes, there is a risk of a self-fulfilling prophecy leading to a successful bid once the right price is struck to tempt the funds to cash in their gambling chips. Mr Carr suggests some changes that might protect British companies. One is greater disclosure of stakes, forcing them to be declared at 0.5% of shares, instead of 1% as at present. Another would be raising the barrier for acceptance of a bid from 50% plus one vote to 60%. More radically, he also floats the idea of removing the vote from shares bought opportunistically during a bid. But such changes risk being either ineffectual or interfering with the liquidity of stockmarkets.

Complex consequences

Drawing broader lessons from the Cadbury episode is difficult, however—not least because the full effects of the takeover have not yet been seen. A trawl through foreign purchases of British firms in recent years suggests that the balance is by no means all negative. There are costs, to be sure: some jobs are lost and some activities move abroad. But by and large foreign takeovers have probably done the economy more good than harm.

First, several have been utilities and infrastructure companies. French, German and Spanish utilities have bought British electricity and water firms and sometimes sold them to each other. This week both the French and German state railways were said to be interested in Arriva, a transport firm. If foreigners think they can run such basic services in Britain better than their previous management, good luck to them: the Spanish firm Ferrovial can hardly do a worse job of running London's Heathrow airport than did BAA, the British firm it took over—although if Ferrovial were to buckle under the huge debt it assumed for the deal, that view might change. With utilities, there is no risk of jobs or skills being switched abroad.

Second, several takeovers fit into a broader picture of global consolidation. Part of the attraction of Arriva is that it owns rail franchises in several European countries. There is little cause to bemoan the takeover in 2007 of Hanson, an aggregates company, by Heidelberg, a German company and a world leader in cement. As with the takeover of RMC by Mexico's Cemex, or Blue Circle by France's Lafarge, or BPB, a plasterboard-maker, by Saint-Gobain, another French group, the Hanson deal was part of a consolidation of building-materials groups: pure cement firms are trying to move downstream and others are seeking to widen their interests. These are basic industries in which closeness to raw materials and markets for their bulky products is paramount. So no British factories will close in the face of imports from Germany, France or Mexico.

Third, a foreign takeover does not necessarily mean a loss of technical expertise. The sale of Smiths Aerospace to General Electric (GE) may also have looked like an example of British emasculation. But Smiths Aerospace was a hotch-potch of businesses put together from the break-up of two other companies, TI and Dowty. The avionics and engine-components firm belongs more logically under the wing of the powerful GE Aviation Systems business, which, with this deal, acquired a foothold in Europe. Meanwhile, the detection equipment, medical systems and industrial seals and hoses arms of Smiths seem to be faring better away from aviation. In the six months to January operating profit was up by 12% on a year before.

In 2006 Pilkington, a world leader in glass, was bought by Nippon Sheet Glass (NSG), a smaller Japanese producer. NSG had previously acquired a 20% stake in the British company; Pilkington had bought some American firms in which NSG had a stake. The agreed merger converted NSG from an Asian regional firm to a global one. Pilkington's head office disappeared from St Helens in Lancashire, its home since 1826, but a research centre survives. For a couple of years the Pilkington boss ran the combined group from Tokyo.

Fourth, head offices often stay. Some have even been shifted to Britain. TUI and Thomas Cook are both firms formed by mergers of essentially German travel companies. TUI is now based in Crawley, a Sussex town near Gatwick airport, and Thomas Cook is back in the West End of London. Petrofac, an oil-services company with its origins in Texas and the United Arab Emirates, also has its headquarters in the West End. GE provides another example: after it bought Amersham, a British nuclear medical systems company, it moved the head office of GE Medical from Milwaukee to Buckinghamshire.

Moreover, some international companies have sought to base themselves in Britain even if their deepest roots are elsewhere. The mining industry is a case in point: Anglo-American, BHP Billiton and Rio Tinto all have head offices in London (although the last two also have them in Melbourne). South African Breweries moved its head office and its stock-exchange listing to London as it prepared to develop internationally. Having bought Miller, an American brewer, it is now known as SABMiller.

Fifth, there is evidence that being bought by a foreign multinational is good for productivity. Nick Bloom, an economist at Stanford, and John Van Reenen, of the London School of Economics, have studied the adoption of good management practices by thousands of companies in several countries. Multinational companies tend to be well managed everywhere; and when they buy firms abroad, they take their practices with them.

Being owned by an American multinational can be especially good for you in one particular respect: Mr Bloom and Mr Van Reenen found that companies bought by American firms increased the productivity of their information technology, whereas those taken over by non-American firms did not. But non-American investors can improve productivity too. The Sunderland factory of Nissan, a Japanese carmaker, is the most efficient in Europe and exports 80% of its output. A Hanson insider explains that the company is being better run now it is owned by Germans, despite the hammering it has taken in the recession. Had it not been for Heidelberg's takeover, he says, Hanson might have struggled to survive on its own.

That is not to say that foreign takeovers are always for the best. But blocking takeovers in order to protect British jobs would undermine the country's long-standing support for an open market for corporate control and open markets more generally, which would make Britain a less attractive place to do business. Subsidies to encourage foreign buyers to keep open British factories and offices impose a cost on the rest of the economy. Ultimately the most important thing the government can do is ensure that British workers are competitive with those overseas. As companies like Rolls-Royce, an engineering firm, GSK, a drugs giant, and ARM, a chipmaker, demonstrate, British companies can prosper in high-skill, high-value industries. Education and skills, rather than protectionism, are still the best way to safeguard British jobs when foreign buyers come calling. ■

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Securitisation

Earthbound

NEW YORK

Large parts of the securitisation markets remain stagnant. Not all efforts to reform them are helpful

FOR most capital markets, the financial crisis resembled a stomach-churning bungee jump: a precipitous fall followed by a sharp rebound, albeit not to the heights enjoyed before the turmoil. The big exception was securitisation, large parts of which are still dangling near the ground. Even as it struggles to recover, the market that brought the world the joys of collateralised-debt obligations faces two stern tests: the phasing-out of central-bank support and a raft of tougher rules.

Securitisation's boom and bust was spectacular. The packaging of mortgages, car loans, credit-card receivables and other debt to sell to capital-markets investors began to take off in the 1980s. By 2006 it was being used to channel around two-thirds of all residential mortgages and half of all consumer credit in America. By distributing loans, banks could cut their capital needs, allowing them to lend more. Hedge funds, insurers and the like gained access to a broader range of credit risks.

As the boom reached fever pitch, however, the quality of the loans being pooled into securities dived, especially in mortgages. When losses started to mount, asset-backed issuance dried up (see chart on next page), forcing governments to take up the slack. In some parts of the market, they are now stepping aside again. The Federal Reserve is winding down its liquidity support for credit-card and car-loan transactions. Some $5 billion of prime, private-label car deals were priced in February. Structured vehicles for risky corporate loans are making a comeback, too.

By contrast, housing markets remain almost wholly reliant on government-backed agencies to package and guarantee mortgage-backed securities (MBSs). No residential MBSs have been sold in America without such backing for more than two years. Europe has seen a few private deals, but these were structured to be highly attractive to investors and acceptable as collateral at the European Central Bank's discount window. No wonder Ralph Daloisio, chairman of the American Securitisation Forum, talked of an "existential" crisis in his speech to the industry group's annual conference last month. He even wondered what Jean-Paul Sartre would make of it.

The prosaic reason for the dearth of private issuance is the wide gap between what investors demand and what borrowers will pay. "Jumbo prime" mortgages, decent-quality loans above the price threshold that Fannie Mae and Freddie Mac can buy at, are likely to be the first part of the new-origination market to come back. But it is currently non-economic to securitise these loans, says Laurie Goodman of Amherst Securities. To place a new issue, given the yields demanded by investors, the interest rate payable by borrowers must be 6.85%, a full percentage point higher than current levels. This differential is "the fundamental issue" for MBS markets, argues Tim Ryan of SIFMA, a securities-industry association. Rating agencies' belated tightening of their methodologies has made this gap even harder to close.

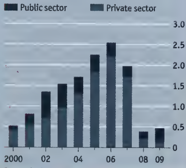
The market for mortgage securities issued by Fannie and Freddie is also about to be tested. The Fed's purchases of almost $1.25 trillion-worth of such MBSs since last year have helped keep rates near record lows. But this programme is due to expire at the end of March. Most think the effect of the Fed's withdrawal will be muted, because the move has been telegraphed and because there is money on the sidelines waiting to take the Fed's place. But rates are still expected to rise at a time when housing demand remains muted: sales of new homes hit a record low in February.

Investors also want the future shape of the industry to be clearer. On both sides of the Atlantic, lawmakers are struggling to strike the right balance between encouraging a revival of securitisation and protecting the financial system from the instability it can produce. Take the bill currently being debated in America's Senate. Few would argue with its tightening of disclosure requirements, including more information on loan repurchases so that inves- ▸▸

Applications are invited for *The Economist*'s 2010 Marjorie Deane internship. Financed by the Marjorie Deane Financial Journalism Foundation, this award is designed to provide work experience for a promising journalist or would-be journalist, who will spend three months at *The Economist* writing about finance and economics. Applicants are asked to write a letter introducing themselves, along with an original article of no more than 500 words that they think would be suitable for publication in this section. The deadline is April 23rd 2010. To apply, visit www.marjoriedeane.com

Crash

Global securitisation deals, $trn



Source: Dealogic

tors can better identify shoddy lenders. Similar calls are coming from central bankers, who want more data on the securities that they accept as collateral.

The benefits of the bill's requirement that securitisers retain 5% of a deal's credit risk are less clear. Toughening up the warranties that securitisers sign, agreeing to buy back duff loans, would have the same effect without tying up precious capital. And forced asset-retention could constitute "control" under new accounting rules. If so—no one seems sure either way—issuers would have to hold capital against the entire deal, not just the retained slice.

Another turn-off is the uncertainty surrounding "safe harbour" rules, which were created to reassure investors in securitised assets that they would continue to receive payments if a sponsoring bank failed. Revisions proposed by the Federal Deposit Insurance Corporation (FDIC)—on hold for now—would punch holes in this ring fence, say industry groups.

A more immediate worry is the cacophony of competing interests exposed by the downturn. Banks that service mortgages, for instance, are reluctant to forgive principal, even if that would benefit borrowers and investors, because it would trigger write-downs of second-lien loans on the banks' own books. One investor likens mortgage securitisation to "class warfare" (although Bank of America's decision to forgive some principal on a limited number of loans may herald a wider ceasefire).

For many, the most off-putting factor is the question-mark hanging over Fannie and Freddie, which have been in government conservatorship since September 2008. Until their role is clarified, the future shape of the market, and the opportunities for private competitors, are unknowable. In testimony this week Timothy Geithner, America's treasury secretary, said that he was committed to encouraging private capital back into the market and to shaking up the two agencies. But no details were offered. Amid such uncertainty "only a madman would ramp up securitisation efforts now," says one banker. ■

Greece's bail-out maths

Safety not

Greece is likely to need far more financial aid than seems to be on offer

IN FEBRUARY European Union leaders vowed to take "determined and co-ordinated action" to protect Greece against a sovereign-debt default and to stop its troubles infecting the rest of the euro area. Weeks later the same politicians are still discussing how precisely to meet that pledge (see page 56).

The need for clarity is now more urgent. Greece has to refinance some €20 billion ($27 billion) of debts that mature in April and May. The yields on ten-year Greek government bonds rose to 6.3% this week, a spread of some three percentage points over German Bunds. The euro fell to its lowest level against the dollar for ten months after Portugal, another troubled euro-zone country, suffered a downgrade.

A standby fund for Greece of €25 billion is rumoured, and euro-zone ministers now seem less frosty at the thought of help from the IMF. That may be enough to calm markets and enable Greece to roll over its debts. But it will be only a temporary fix. It will take years to repair Greece's public finances, which means a much larger rescue fund will be needed if it is to avoid default.

The Greek government has somehow to keep its economy on an even keel while pushing through a huge fiscal tightening. Countries that seek IMF help generally have to endure brutal cuts in public spending, which deepen recessions. To counter that effect, the IMF typically counsels a weaker currency. Sadly, this is not an option for Greece. Stuck in the euro, its exchange rate with its main trading partners is fixed. Greece cannot devalue, so it needs more time to adjust than the three years it has agreed with its EU partners—and a bigger safety net while it does.

Just how big? Analysis by *The Economist* suggests a figure of €75 billion rather than €25 billion. Greece is likely to need five years to get its deficit down below 3% of GDP (see table). On our projections interest payments will rise from 5% of GDP to 8.4% in that time, to reflect the higher cost of issuing new debts and of refinancing old ones. Other budgetary cuts will be needed to offset this. By our reckoning the Greek government will have to increase the "primary" budget balance (ie, excluding interest payments) by 13.5 percentage points of GDP to cap its debt burden. That is bound to have an effect on growth. Our projections assume that nominal GDP will be 5% lower by 2014.

This is necessarily a stylised analysis, which requires some brave assumptions (some of which may even be too kind). The estimate of how big a bail-out Greece may need hinges on a particularly heroic one: that private investors have had their fill of Greek bonds but would still roll over existing debts if a bail-out fund covered the country's new borrowing. Our projections imply that Greece will run-up an extra €75 billion of debt by 2014, by which time its debt will stabilise at 153% of GDP. This figure is a rough guide to how much financial aid Greece may require.

That may be too much even for the newly flush IMF. For its share of Latvia's rescue, says Laurence Boone of Barclays Capital, the fund stretched to 12 times the country's "quota", the amount a member country contributes to the fund's coffers. A €75 billion package would require the IMF to provide around 40 times Greece's quota if the costs were split with the EU.

Optimists say that demand for Greek bonds will revive as its budget deficit falls and confidence returns. There is no theory that says investors will tolerate debts of 113% of GDP (Greece's ratio in 2009) but balk at anything higher. Japan's gross public debt is almost 200% of its GDP with as yet few signs of revulsion. But Japan is the only sovereign issuer of yen bonds, while ▸▸

A ruinous picture

Greece's:

	2009	2014*	Change
Nominal GDP (€ billion)	237.5	225.6	-5.0†
Debt (% of GDP)	113.4	152.5	39.1‡
Deficit (% of GDP)	-12.7	-2.6	10.1‡
Interest payments (% of GDP)	5.0	8.4	3.4‡
Debt (€ billion)	269.3	344.2	74.9

Sources: European Commission; *The Economist* *Economist projections †Percent ‡Percentage points

Greece is the least creditworthy of the many countries offering euro bonds. Japan is a creditor nation that can rely on domestic savers. Greece is a deficit country that depends on "footloose" investors, says Thomas Mayer of Deutsche Bank.

Greek bonds are attractive because of their generous yields. If the interest-rate spread stays close to 3%, a buyer of a ten-year German bond who holds it until it matures would make only three-quarters of the return he could make on a similar Greek bond. For bold investors, such a gap is ample insurance against the risk that Greece may not able to pay back all it has promised. Others think the reward may not be worth the gamble. A debt restructuring, where bondholders are forced to swallow losses, is a "substantial risk" if recession in Greece drags on, says Marco Annunziata of UniCredit. Its would-be rescuers may conclude that throwing money at a weak, if profligate, country is still the cheapest way to stop trouble spreading. But the likely bill for Greece's bail-out looks larger than many are assuming. ■

Rising prices in Asia

A weight on their shoulders

Inflation in Asia is not as bad as it looks

SUPPORTERS of Mayawati, a member of India's downtrodden castes who is now chief minister of Uttar Pradesh, India's most populous state, show their appreciation by offering her garlands to wear around her neck. The one presented to her at an event earlier this month was enormous. It was estimated to weigh 65kg, according to the *Times of India*. The garland was made not of marigolds, but of crisp 1,000 rupee ($22) notes.

That is as good a sign as any that money is too easy in India. Consumer prices for agricultural workers (among whom Mayawati has her supporters) rose by 16.5% in the year to February. Wholesale prices, which the central bank watches more closely, rose by 9.9% over the same period. That prompted the Reserve Bank of India (RBI) to raise interest rates on March 19th by 0.25 percentage points, without waiting for its scheduled meeting.

The central bank's decision follows rate hikes by the central banks of Australia, Malaysia and Vietnam. The RBI perhaps should have beaten them to the turn. But like other Asian central banks, it was nervous of raising rates while America's rates were on the floor. It also blamed rising prices on the worst monsoon since 1972, which hurt the harvest of foods that weigh so heavily in India's inflation indices, especially its four measures of consumer prices. In those circumstances, the central bank's duty is not to stop a one-time jump in prices. It is only to prevent this jump spilling over into broader inflation, creating expectations of future price rises that can become self-fulfilling.

Such a spillover is now visible. In a statement accompanying the rate rises, the RBI noted that wholesale prices of non-food manufactured goods, which had fallen by 0.4% in the year to November, were now rising by 4.3%. A survey by Hewitt Associates suggests that employers will raise salaries by 10.6% this year, compared with a 6.6% rise in 2009. And in an article in *Economic and Political Weekly*, an Indian journal, Rajiv Kumar of the Indian Council for Research on International Economic Relations and his colleagues note that rice retailers charged a markup of 12% over the wholesale price in December 2009, compared with 8% a year earlier. They believe this is suggestive of the "hoarding" that politicians like Mayawati love to blame for higher prices.

Having never fallen as steeply as elsewhere in Asia, India's wholesale prices are now rising faster than anywhere except Thailand (see chart). "India is at one extreme," says Robert Prior-Wandesforde of HSBC. Elsewhere, he says, the upward swing in the global price of commodities such as oil, food and metals, is beginning to show up in broader prices but the inflationary pressure is not remotely like 2008.

In that year commodity prices were rising much faster and Asia's economies were wound much tighter. After several quarters of robust growth, industrial production has caught back up with its long-term trend in all Asian countries except Japan, Singapore and Malaysia, according to HSBC. In 2008 it was far above this trend. Under those conditions, firms passed higher costs onto consumers quite promptly.

Mr Prior-Wandesforde believes headline inflation in Asia will peak soon. Having doubled last year, oil prices would have to double again to maintain the same rate of increase, he points out. But that does not mean Asian central banks can rest easy. Given the lags that afflict monetary policy, they must set rates today for the Asian economy of 18 months from now. Their policies still reflect nervousness about a relapse in America and Europe. They are consequently too loose for a region that is recovering so briskly.

Even in India the spring harvest should help quell wholesale-price inflation. But these prices are a poor guide for India's monetary policy. They tell the central bank a lot about forces it cannot control, such as the monsoon and the global commodity markets. But they tell it little about the things it can hope to influence, such as domestic demand. The RBI, according to Mr Prior-Wandesforde, is "flying blind most of the time".

In its statement, for example, the central bank cited increasing capacity utilisation as an inflationary threat. By one measure, prepared by the National Council of Applied Economic Research in Delhi, capacity utilisation has returned to its pre-crisis peaks. But India lacks a robust measure of core inflation, or comprehensive measures of employment and wage pressures. Inflation watchers must instead take their cues from surveys, casual observation and telling anecdotes—as well as the weight of money garlanding politicians' necks. ■

Life insurance in Asia

Age concern

TOKYO

Local investors show confidence in shrinking markets

INVESTORS may salivate over insurance prospects in the emerging markets of Indonesia, India and China, but the more mature Asian markets seem to have life in them yet. On March 17th Korea Life became the first of the country's big life insurers to go public. Others are following. Dai-ichi—a household name in Japan—this week priced an $11.2 billion initial public offering, the biggest since Visa's $19.7 billion listing in 2008. Samsung Life, another South Korean industry heavyweight, hopes to come to market in May. Foreign firms are also taking up positions in the region's greyer markets: Alico, an AIG subsidiary which makes 70% of its revenue in Japan, has just been snaffled by MetLife.

At a time when new investment opportunities are few and far between, the arrival of an entire industry on Japanese and South Korean stockmarkets has attracted lots of attention, particularly from locals. Korea Life's shares debuted below initial estimates due to weak foreign demand, ▸▸

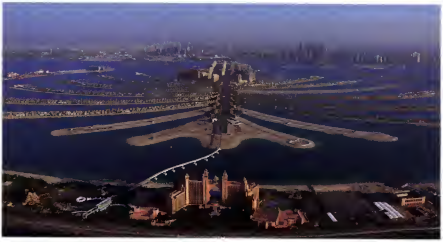
but since trading began prices have risen by a respectable 8%. It was a similar story with Dai-ichi, which scaled back its allocation to foreign buyers but saw heavy demand from domestic retail investors.

On the surface, foreign wariness seems more sensible. Japan, Taiwan, Singapore, Hong Kong and South Korea are all highly penetrated markets (see chart). Their nurseries are not exactly brimming with future policyholders. Insurance premiums are shrinking overall in Japan. Yet insiders insist that there is still room for growth.

Stephan Binder of McKinsey, a consultancy, thinks that people should be insured for 10-12 times their annual income. By this measure, Asians (and, for that matter, everybody else) are woefully underinsured. What's more, social-security entitlements in the region are paltry compared with other rich countries. So annuity schemes are a natural supplement for retirement income. Japan, the greyest of the Asian countries, is already seeing the effects of demographic change. The *dankai* generation—which refers to the 8m people born between 1947 and 1949—spent 14.5 trillion yen ($125 billion) on insurance with individual annuities in 2006. And that was before most of them had retired.

Another avenue for growth is in healthcare plans, which are undersupplied. In the Japanese market, over half of new policies cover medical costs such as cancer. Other Asian countries are sure to follow as the savvy pre-retirement generation—who no longer believe that their families will care for them, and do not think government schemes will suffice—start to think about their future. Joseph Ngai of McKinsey reckons that rich Asia could see 11-12% growth in insurance premiums.

Short-term prospects are all very well, but these shrinking—and, in the cases of Singapore and Hong Kong, tiny—markets are bound to dry up at some point. Dai-ichi and Korea Life have both already expanded into South-East Asia to unlock new sources of growth. Raising funds will enable them to make further inroads abroad. Those immature markets may yet hold the key to insurers' long-term success. ■



Dubai's debts

Finding the ripcord

Dubai reveals how it wants to restructure its debts

EARLIER this year, Nasser al-Neyadi from the United Arab Emirates (UAE) leapt off Dubai's newly opened Burj Khalifa, the tallest building in the world. He descended 672 metres (2,205 feet) in less than a minute, his fall broken by a parachute which opened ten seconds into the jump.

From the heady heights it reached in 2008, Dubai, one of seven members of the UAE, has fallen almost as far and as fast. Its hopes for a soft landing have always rested with its wealthy neighbour, Abu Dhabi, which sits on over 90% of the UAE's oil reserves. But for a few horrible weeks at the end of last year, Dubai's parachute refused to open—or perhaps the emirate simply fumbled as it reached for the ripcord.

On November 25th Dubai threatened to default on a $4.05 billion *sukuk*, or Islamic bond, issued by Nakheel, a troubled property developer belonging to Dubai World, one of three government-owned conglomerates that set the pace for Dubai's development. The announcement threw the emirate and the global credit markets into a vertiginous free fall. As the ground approached, Abu Dhabi released more funds and the *sukuk* was eventually paid on time. But Dubai World's other debts remained to be restructured. It was not clear who would get paid, how much or when.

On March 25th Dubai provided some answers to those questions. It announced no new money from its neighbour or anywhere else. But it spelled out in greater detail than before how its existing bail-out funds would be divvied up among companies, creditors, customers and suppliers.

This process will be overseen by the Dubai Financial Support Fund, which holds the purse strings and no doubt takes many of its cues from Abu Dhabi. The fund introduces crucial distance between the people who run Dubai and the commercial ventures they sponsor. It has been called a "value-for-money committee".

It will give Nakheel itself $8 billion, as well as converting an earlier $1.2 billion loan into equity. It will convert another $8.9 billion of debt in the Dubai World holding company into equity, as well as providing another $1.5 billion in new money. Of the fresh funds, $5.7 billion will come from loans already provided by Abu Dhabi. The remainder will come from the Dubai government's own resources.

What will the companies do with this money? Dubai World says its outstanding debts to outside creditors amounted to $14.2 billion at the end of 2009, not counting the money it owes to the Support Fund or the money owed by Nakheel. It says it will repay the principal on its debts with new IOUs maturing in five or eight years. It said nothing about interest.

Nakheel itself still owes about $9.3 billion, including loans, bonds and payments due to suppliers. Holders of publicly traded debt instruments, such as its *sukuk* due this year and next, will be repaid as scheduled. For everyone else it is a bit more complicated. Nakheel's bankers, including bilateral and syndicated lenders, will be paid in full but not on time. The company's individual contractors and suppliers, who have suffered silently but deeply in this crisis, will soon get a cash payment of up to 500,000 dirham ($136,000). That should clean Nakheel's slate with half its contractors, the firm says. ▸▸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The other half will have their claims settled by a mix of cash and a tradable IOU.

The deal also addresses Nakheel's customers. Many provided money upfront for properties, some of them to be developed on artificial islands off Dubai's coast, whose viability is unclear. The company will either pay customers back over time (without interest), or offer them an alternative property that is closer to completion.

Dubai will now try to sell the deal to its creditors. They are likely to buy it. Indeed, many of them were on the co-ordinating committee that helped negotiate it. The restructuring broadly conforms to what bankers were expecting in October, before all the fumbling, flapping and falling at the end of last year. That ungainly descent should now come to an end. But it is still an awfully long way back up to the top. ■

The FSA gets tough

From light touch to heavy brigade

Britain's biggest insider-trading case fits a pattern

TO GIVE the Financial Services Authority its due, it tends to mean what it says. In 2006 Margaret Cole, the director of enforcement at Britain's financial regulator, boasted that when it came to light-touch regulation "nobody does it better" than the FSA.

In 2009, too late to prevent the financial bubble which had been facilitated by lax regulation, the watchdog abruptly began to show its fangs. Hector Sants, its outgoing chief executive, talked of an "intensive supervisory model", which should make people "very frightened" of the FSA. Ms Cole laid out a new policy of "credible deterrence" which involved making sure that the authority's punitive actions grabbed the headlines. That year saw a big change in the level and nature of fines imposed by the FSA: £34.9m ($54.6m) compared with £22.7m in 2008 and just £5.3m in 2007.

It has got even tougher since then. On March 23rd, in what the FSA said was its biggest investigation yet into insider trading, police and FSA officers raided 16 premises and arrested six people, among them employees of Deutsche Bank, BNP Paribas and Moore Capital, one of the world's biggest hedge funds. A seventh arrest was made the next day. Charges are expected shortly.

The raids follow a series of high-profile penalties handed down by the authority. On March 16th a former interest-rate trader at Merrill Lynch was banned from London's financial markets for at least five years for covering up losses. Five days earlier a former stockbroker at Cazenove was jailed over an insider-dealing case brought by the FSA.

In its plans for the coming financial year the authority promises a further toughening: an extra 460 staff will be taken on and the FSA's budget will be increased by 10%, as it makes its inspections more intrusive. The largest British banks will each have 15 officials permanently stationed at their headquarters, up from six before the financial crisis.

Such plans have an otherworldly feel to them. The opposition Conservatives have pledged that if they win the coming general election, they will abolish the FSA, handing the job of supervising financial institutions to the Bank of England. But whichever agency ends up regulating finance in Britain after the election, the FSA's new-found ferocity is likely to set the tone in years to come.

Carbon markets

The wrong sort of recycling

Hungary's sale of used carbon credits damages investor confidence

THE point of carbon markets is to put an efficient price on the right to emit carbon dioxide. Recent events in Hungary show how tricky it is to achieve that goal. At issue is the sale by Hungary's Ministry of Environment and Water of 800,000 certified emission-reduction credits (CERs). CERs are generated by the Kyoto protocol's "Clean Development Mechanism", whereby reductions in greenhouse gases in developing countries can produce a carbon credit for use in industrialised markets. The problem with the sale was that Hungarian firms had already used the CERs to offset their own emissions.

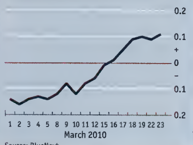
Used credits are worthless on European carbon exchanges. The European Union argues that one credit must equal one tonne of carbon dioxide for its Emissions Trading Scheme, the largest emissions market, to be effective. Since the whole point of the credits is to cut carbon, double-counting them makes a mockery of the system.

But the rules of carbon trading are slacker elsewhere. Hungarian officials say the credits were ultimately destined for a buyer in Japan. Japanese firms can use the credits to prepare for their country's own looming emissions-trading scheme, and the Japanese government can use them to meet its Kyoto commitments. "In Japan's view, so long as some environmental benefit has occurred, then the CERs have a value," says Yuichi Takayama, the boss of Tokio Marine Asset Management.

The trouble arose when these used CERs found their way back—how is unclear—on to BlueNext, an exchange based in Paris. (By that time they were out of the hands of the Hungarian ministry, so technically the country did not break any rules.) Once the European Commission realised what had happened, all hell broke loose. BlueNext temporarily suspended trading on March 17th. That sent the spot price for CERs into free fall. Though trading has since resumed and the price has bounced back to around €11 ($15) per tonne, Abyd Karmali, global head of carbon markets for Bank of America Merrill Lynch, says there are signs that investor confidence has been hit.

CERprise

Spread between CERS expiring in December 2010 and December 2012, euros



Source: BlueNext

In particular, there has been a "flip in the curve" of CER prices. Normally, longer-dated futures contracts are more expensive than shorter-term ones. That pattern has reversed since the Hungarian debacle (see chart), with the price of a CER expiring in December 2012 being priced lower than one running out this year. "This tells us investors anticipate this won't be last time we see recycled CERs hitting the market," says Mr Karmali. Indeed, Hungary has said it intends to sell more recycled credits but will put more stringent rules in place to ensure they do not wash up in Europe.

The incident adds to the difficulties of finding a successor to Kyoto, which expires in 2012. Its architects believed making the various flavours of carbon credit fungible was the best way to make the system work. Closing the loophole on double-counting could put off new entrants. Keeping it open would be even worse. Flooding exchanges with recycled CERs that do not yield any additional project finance in poor countries would not be doing the market any favours. "The environmental industry has a spectacular knack for scoring own goals," says Gavin Tait of Croft Consulting. ■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Economics focus | Tricky Dick and the dollar

Does Richard Nixon have anything to teach Barack Obama about economic diplomacy?

THE "Nixon shock" is not the name given to President Richard Nixon's resignation in 1974 amid the Watergate scandal, his bombing of Cambodia during the Vietnam war or his audacious visit to communist China. It refers instead to a bundle of economic policies unveiled to an unsuspecting world on August 15th 1971. The president imposed a freeze on wages and prices for 90 days to break inflation, ended the convertibility of dollars into gold, and slapped a "surcharge" or tariff of 10% on imports.

Nixon is not usually a source of inspiration for left-leaning pundits such as Paul Krugman of the *New York Times*. But like 130 congressmen, who this month signed a letter to Timothy Geithner, America's treasury secretary, he is calling on the White House to emulate Nixon and impose a "surcharge" on imports from China. The tariff is supposed to force China to strengthen its currency, the yuan, against the dollar, just as Nixon's surcharge prompted America's trading partners to renegotiate their exchange rates four months later.

Mr Krugman argues that China's weak yuan is costing America roughly 1.4m jobs. Its cheap currency gives its exporters an edge in the American marketplace. China then squirrels its dollar earnings away in American securities rather than spending them on American goods. In normal circumstances these asset purchases would lower interest rates, boosting American borrowing and spending. But America, like other rich countries, is now caught in a "liquidity trap". Interest rates are as low as they can go. By saving dollars rather than spending them, China is draining demand from the world economy.

China's foreign-exchange reserves now total $2.4 trillion, of which about 70% are thought to be in dollars. In 1971 the central banks of America's trading partners had amassed a rather smaller hoard, of about $40 billion. But that was enough to buy the gold in Fort Knox three times over, if America upheld its commitment to sell the metal at $35 an ounce. Britain's request to exchange dollars for gold on August 13th 1971 was the last straw. "Although the US government attached no great importance to the gold as such, a run on this gold would have been a sorry spectacle," wrote George Shultz and Kenneth Dam, two prominent economic officials in the Nixon administration, in their book "Economic Policy Beyond the Headlines". On August 15th Nixon, in effect, announced that America was now unwilling to do what it would soon be incapable of doing—converting dollars into gold at the agreed exchange rate.

Messrs Shultz and Dam argue that the import surcharge was intended as "an attention-getter and a bargaining chip". It allowed John Connally, Nixon's treasury secretary and a Texan, to stride down the corridors of international finance "with both guns blazing". In the face of this bravado America's trading partners duly backed down. By December they agreed to let the dollar fall (by a trade-weighted average of 6.5%) and the surcharge was removed. Nixon was able to present the humbling of the dollar as a political victory. But were Barack Obama to emulate him, would he really enjoy the same result?

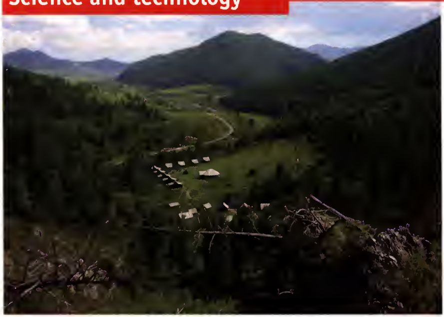
The obvious difference is that in 1971 America was locked into a system of fixed parities. By pegging to the dollar, a currency was automatically fixed to everything else. Since July 2008 China has pegged the yuan to the greenback. But over that period its currency has swung up and down against those of its trading partners and competitors. On a trade-weighted basis the yuan is back to where it was when the financial crisis started. Indeed, compared with China's emerging-market competitors in its big export markets, the yuan is about 12% more expensive today than it was before the collapse of Lehman Brothers, according to a measure (the "third-country" effective exchange rate) calculated by the Hong Kong Monetary Authority. By this indicator China's currency is about 25% above its level in 2005.

The second difference is related to the first. Because everybody was pegged to the dollar in 1971, everybody had to pay the surcharge. Nixon dismayed everyone but discriminated against no one. China's critics today, on the other hand, urge Mr Obama to slap a tariff on Chinese goods alone. This will reduce the demand for Chinese imports, which constitute about 15% of America's total. But there is no guarantee that customers will switch from Chinese goods to American ones instead. They are more likely to buy from China's rivals in Asia. The surcharge may change the composition of America's trade deficit, without necessarily changing its size.

Nixon goes to China

The Nixon shock holds lessons for China as well as Mr Obama. Like China today, Germany in the 1960s disavowed any responsibility for the world's imbalances, insisting that the solution lay with tighter policies in deficit countries rather than looser policies in surplus countries. (Germany is still singing a version of that song.) But by holding fast to the dollar, Germany ended up importing America's laxity. It could not insulate itself from the loose monetary policy engineered to help Nixon win the 1972 election. German prices rose by over 5% in 1971. China, too, risks a loss of macroeconomic control if it continues to peg to the dollar. Its money supply grew by about 35% in the year to February. That kind of surge may be a precursor to inflation.

The advocates of a surcharge argue that China will not act unless it is forced to do so. They point to defensive remarks by Wen Jiabao, China's prime minister, arguing that the yuan was not undervalued and would remain "basically stable". But the demise of the Bretton Woods system suggests that official statements can be a poor guide to future policy. The decision not to revalue is "final, unequivocal and for eternity". That's not a Chinese official in 2010, but a German official in the Nixon era—just five months before the Deutschmark was revalued by 9.3%. ■



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A new species of human

The old man of the mountain

The fossil record reveals both a hitherto unsuspected mountain-dwelling hominid and, in the following story, how the dinosaurs began

MYTH and fantasy populate the world with "othermen"—the elves, goblins, dwarfs and giants that live in the wild wood, in the cave or on the high mountain peak. Not animal, but not quite human either, they feed fear and imagination in equal quantity. Nor are such creatures merely the province of the past and the poetaster. The story of the yeti—the abominable snowman that haunts the Himalaya—has provoked serious investigation by explorers hoping to find not-quite-human humans. Sadly, there is nothing there. But not so long ago there might have been. For a bunch of explorers of a different sort, using DNA sequences instead of hiking boots, have discovered a real otherman from the mountains of Asia.

Svante Paabo, of the Max Planck Institute in Leipzig, was the inspiration for Michael Crichton's novel "Jurassic Park". His group extracts and sequences genetic material from fossils, and has produced DNA analyses of both mammoths and Neanderthal man. Their latest object of study is a finger bone found in a cave in the Altai Mountains of southern Siberia (pictured above). The team Dr Paabo assembled to look at this bone, led by Johannes Krause, assumed it was either from an early modern human or a Neanderthal, both of whom once lived in the area. What they found shocked them. It was neither.

The new, as yet unnamed species—the first to be defined solely by its DNA—is unveiled in this week's *Nature*. Anatomically, it consists of the distal manual phalanx of the fifth digit or, in layman's parlance, the tip of the little finger. Even by the standards of palaeontology, one of whose early practitioners, Georges Cuvier, claimed to be able to extrapolate an entire animal from a single bone, declaring a species from evidence this slight would be ambitious. It was not the bone itself, though, but what was in it, that allowed Dr Krause and Dr Paabo to be so confident.

Fingering the truth

From 30 precious milligrams drilled out of the sample they extracted mitochondrial DNA. The mitochondria, a cell's power packs, are the much-modified descendants of bacteria that took up residence in the ancestors of modern animal and plant cells a billion years ago. As a relic of that ancestry they still have a few genes of their own and, because each cell has thousands of mitochondria, those genes are easier to find in old samples than are genes from the nucleus, of which there is only one per cell.

Using the latest DNA-sequencing technology, Dr Krause and his colleagues worked out the order of the genetic "letters" of over 1m fragments of DNA from their sample. By looking for overlaps between these fragments and fitting the resulting contiguous sequences to reference sequences from humans and Neanderthals the team were able to come up with a DNA sequence for most of the mitochondrion, and it was nothing like one that would have been expected from either a modern human or a Neanderthal.

The rate at which random changes over the generations occur in mitochondrial DNA is fairly well known and, using that knowledge, Dr Krause estimates that the newly discovered species last shared an ancestor with modern humans about 1m years ago. That is extraordinary. It means that its ancestors must have emerged from Africa (where that million-year-old common ancestor would have lived) independently of the migrations which gave rise to Neanderthals and humans.

The common ancestor is, however, too recent for the new species to be a remnant of the first human excursion from Africa, the one that led to Java man and Peking man, now known as *Homo erectus*. It is, in other words, a fourth example of anthropological tourism from Africa to the rest of the world, on what is now looking like a well-worn route. Yet it is the lone example. That shows how fragmentary and ill-understood human history is.

The finger bone was found in strata dated to between 48,000 and 30,000 years ago (the bone itself has not yet been dated). That means the creature was contemporary with both Neanderthals and modern humans in the area. There was, then, a real ecosystem of othermen in southern Siberia. In 2003 the scientific and popular press were both filled with the discovery of a similar arrangement on the Indonesian island of Flores. A hitherto unsuspected species of dwarf human turned up in caves there, contemporary with modern humans. It was quickly dubbed the "hobbit". Do not be surprised if, whatever proper name it is eventually assigned, the new, mountain-dwelling, central-Asian species actually becomes known as the yeti. ■

The rise of the dinosaurs

Easy come, easy go

The dinosaurs went out with a bang, but they arrived after chaos

REVOLUTIONS have unpredictable outcomes. Who is going to end up in power is rarely obvious at the start. That is as true in biology as it is in politics. Like political revolutions, though, biological ones often follow a predictable course. The old order is destroyed. There is a period of confusion. Then a new ecosystem emerges that looks surprisingly like the old one, but with different actors.

This cycle has happened five times in the history of modern life. The most famous occasion was 65m years ago, when the dinosaurs were wiped out and the mammals emerged victorious from the wreckage. A bigger mass extinction, at the end of the Permian period 251m years ago, killed 70% of the world's land vertebrates (and 96% of all marine animals) and paved the way for the age of reptiles.

Exactly which sort of reptile would come out on top, however, was not something that was decided until later—201.4m years ago, to be precise. This was towards the end of the Triassic period. Then, the ranks of aetosaurs, phytosaurs, shuvosaurs and many other uncrocodile-like relatives of the crocodiles were suddenly thinned, and a previously obscure group came to the fore. The result, once natural selection had done its work over the course of millions of years, was the now familiar cast of *Allosaurus*, *Diplodocus*, *Triceratops* and *Tyrannosaurus rex*.

Another one bites the dust

The dinosaurs were done for, as everybody knows, by a collision with an asteroid. The Permian was curtailed by massive volcanism. But what exactly happened towards the end of the Triassic has been much debated. A study just published in the *Proceedings of the National Academy of Sciences*, by Jessica Whiteside of Brown University in Rhode Island and her colleagues, pretty well nails it down. It was the geological chaos that created the North Atlantic Ocean.

Dr Whiteside used fossil evidence sandwiched between layers of lava from some of the earliest eruptions that accompanied the rift. Specifically, she located two sites in what is now eastern North America where a series of giant lakes had formed on the layers of cooled lava and plant matter had accumulated at the bottom of the lakes. Using detailed chemical analysis of waxy molecules extracted from the fossil plants, she examined the carbon isotopes they contained.

Non-radioactive carbon comes in two forms: ^{12}C and the heavier (and much rarer form) ^{13}C. The ratio varies in the atmosphere, depending on where carbon-rich gases, mainly carbon dioxide and methane, are coming from. Dr Whiteside found the ratio yawed around like a drunken sailor as the continents split apart and the lava started pouring out. First, the level of ^{13}C plummeted. Then it shot up again, a long way over the recent historical average, before settling down.

Crucially, the period of plummeting coincides with a phenomenon called the late Triassic fern spike. This marks precisely—to within a few thousand years—the point of mass extinction on the land. What is believed to have happened is that something killed all the forests and with them the animals that depended on them. Freed from the competition for light (because the shade from the trees had gone), ferns flourished (their spores are ubiquitous in the rocks). Previous work has suggested that the oceans also became acidic at this time. Shelled creatures, whose calcium-carbonate-rich armour tends to dissolve in acid, suddenly became rare.

Put it all together and the probable course of events was this. The initial volcanism as North America split from Europe released carbon dioxide from deep inside the Earth. That produced a greenhouse effect which, in turn, melted seabed structures known as methane ▸▸

Archaeology

Shining a light on the past

How to bring out the best in ancient artefacts

LOOK at an ancient coin under ordinary light and the chances are that its features, worn down by its passage from hand to hand, will be hard to make out. Point a spotlight at it, though, so that the face of the coin is illuminated from an acute angle, and the resulting shadows will emphasise any minor details.

This is the basic principle behind a novel technique that is helping archaeologists reveal previously invisible clues hidden in the worn or damaged surfaces of any objects they uncover. From wall paintings in Herculaneum to Scandinavian stone tools to rock art in Libya, polynomial texture mapping, as the process is known, is proving an invaluable way to illuminate the past.

The lighting method was originally developed by Tom Malzbender, a computer scientist at HP's laboratory in Palo Alto, California, to generate better 3-D imagery for computer games. In its most basic form, the process involves capturing between 30 and 50 digital photos of an object of interest. The pictures are taken from directly above the object in a darkened room. Though the camera is fixed, the object is lit from a different angle in every shot. The photos are then combined on a computer to create an image that can have a "virtual" light shone from various angles to reveal any hidden surface detail. The wavelength of this virtual light can also be changed using the computer, allowing colour-sensitive details of the artefact's surface to be brought out more clearly.

The Antikythera in a new light

Graeme Earl of the University of Southampton, in England, has used the technique to study wall plaster from the Neolithic settlement of Catalhoyuk in Turkey and artefacts including consular brick stamps found at Portus, an ancient harbour at the mouth of the Tiber. He has also carried out trials which suggest that the use of a high-speed video camera can accelerate the process, so that it can be used in the field.

The technique has also been used to increase the number of readable characters on the Antikythera mechanism—a badly corroded geared device that spent more than 2,000 years at the bottom of the sea—from 800 to more than 2,000. It has also enhanced cuneiform inscriptions—markings made in clay tablets dating back as far as 3000BC that are the earliest known form of writing. Many video games, from "Tomb Raider" onwards, borrow from archaeology. It is nice to see video-game technology returning the favour.

clathrates, which trap that gas in ice. This caused a massive release of ^{12}C-rich methane into the atmosphere, explaining the initial drop in ^{13}C concentrations. The methane, being a much more potent greenhouse gas than carbon dioxide, exacerbated things, while the carbon dioxide acidified the oceans, killing most of the animal shellmakers and fertilising the photosynthesis of planktonic plants. The subsequent plankton bloom sucked up the ^{12}C and the isotope ratio veered off in the opposite direction.

The greenhouse warming and the acid rain also did for the forests and many of the reptiles. Only once things had settled down could the survivors regroup. New species of trees took over. The forests grew back. And a bunch of hitherto not-so-terrible lizards began their long march. ■

Trade in endangered species

Fishy business

DOHA

How the elephants' success hurt the bluefin tuna

AS OLD hands tell it, protecting a threatened species used to be a relatively straightforward affair at the Convention on Trade in Endangered Species of Wild Fauna and Flora (CITES). Government officials would turn up at the triennial meetings and, after listening to advice from scientists, conservationists and their own environment ministries, were likely to agree to a "listing".

This year at its meeting in Doha, everything changed. Seemingly alarmed by the large number of proposals to list marine species, Japan turned up in force. Japan's 30-strong delegation was as big as the one from America. And thanks to its "capacity building" efforts—in other words, providing finance for projects in developing countries—Japan was also able to fly in a dozen or so fisheries ministers, mostly from Africa, to ensure their participation—and, no doubt, their votes.

CITES has become a battleground because it is a strong convention. It is one of the few places where global environmental laws are made. It can ban trade in a species (an Appendix 1 listing), or limit that trade so that it has to be carried out sustainably using permits (Appendix 2). As a consequence, says Sue Mainka, head of the delegation from the International Union for the Conservation of Nature, an environmental group, the people who come to the meetings are changing. Governments are increasingly sending delegates from trade and fisheries ministries, rather than environment and wildlife officials. Industry groups have also expanded their lobbying efforts. And the receptions to woo delegates are changing: Japan hosted two events where bluefin tuna, a critically endangered species, was pointedly served. (Your correspondent tried to attend one but was asked to leave because the press were excluded.)

All of which helps explain why bluefin tuna, some 80% of which is consumed in Japan, was refused a listing in a vote on March 19th, even though scientists agree that it qualifies for Appendix 1. One of the arguments given by Japan and its allies for rejecting the proposal was that there is already an organisation that exists to manage bluefin—the International Commission for the Conservation of Atlantic Tunas (ICCAT). But this is something of a red herring, as it were. An Appendix 1 listing would not prevent ICCAT from managing the fishery or setting local fishing quotas. Rather, it would reduce demand and thus provide the restraint on tuna fishing that ICCAT has failed to.

Behind the scenes, there was also a feeling among some countries that the European Union (which supported an Appendix 1 listing for bluefin) would benefit unfairly, because its fishermen would still be allowed to trade bluefin between EU countries. Such trade is technically domestic and does not therefore fall under CITES. To complicate matters, many observers think the EU is one of the villains at ICCAT. According to Masanori Miyahara, chief counsellor from the fisheries agency of Japan, "The EU caused this mess." Japan seems to think the EU needs to try harder to make ICCAT work.

Bluefin was not the only sea creature which lost out. Red and pink coral, a group of deep-sea species that have suffered from years of over-exploitation, were turned down for an Appendix 2 listing. A joint American-European proposal would have required states that export items made from the corals to certify that the trade was sustainable and issue permits. Japan, once more, was against it.

Sharks did badly too. The main committee of CITES discussed a group of them, including the hammerhead, oceanic whitetip, porbeagle and spiny dogfish. There was wide scientific support for most of them to get an Appendix 2 listing. In a close-run vote on March 23rd, all except the porbeagle failed. Discussions continued as *The Economist* went to press.

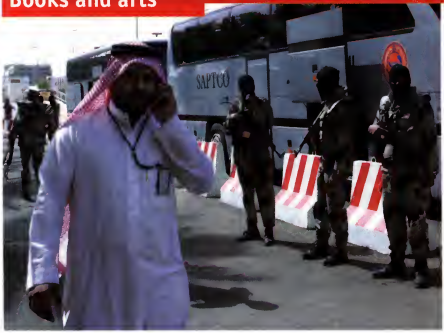
"I think the Japanese are against any further inclusions of marine species into CITES," observed Sue Lieberman of the Pew Environment Group. "We look on a case-by-case basis, but as a general principle we are not convinced CITES measures can help," says Mr Miyahara. Regional fisheries-management organisations such as ICCAT are a better solution, he argues.

Elephants remain

Japan is sceptical about CITES because of the way it has been applied to elephants and other land animals. Even when endangered populations recover, it has proved difficult to reduce or remove CITES protection. After intense lobbying by other governments and wildlife charities both Tanzania and Zambia were denied applications to move their elephant populations from Appendix 1 to 2.

"Fisheries have to change in accordance with fish reserves, and CITES is not flexible," says Mr Miyahara. Sunset clauses on CITES listings, as well as formal links between CITES and regional fishery bodies such as ICCAT, would help Japan overcome its objections, he adds. This means governments and wildlife campaigners have just under three years to adjust their campaign strategies accordingly, if they hope to protect more marine species at the next meeting, in 2013. ■

Tuna getting ready for the table



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Saudi Arabia

The struggle for its soul

Two books about the desert kingdom draw surprising conclusions about the tensions between conservatives and modernists, clerics and terrorists

Inside the Kingdom: Kings, Clerics, Modernists, Terrorists, and the Struggle for Saudi Arabia. By Robert Lacey. *Viking; 432 pages; $27.95. Hutchinson; £20*

Jihad in Saudi Arabia: Violence and Pan-Islamism since 1979. By Thomas Hegghammer. *Cambridge University Press; 304 pages; $29.99 and £18.99*

SAUDI ARABIA is a land of superlatives. It has the biggest oil reserves in the world, the driest deserts and the holiest cities of Islam, as well as the most stubbornly autocratic of governments and irksomely puritanical people. But the realm that was patched together in the early part of the last century by its first king, Abdel Aziz ibn Saud, with an equally energetic mix of *jihad* and tribal diplomacy, also ranks as one of the most poorly understood countries. Critics portray the kingdom as an oily heart of Islamic darkness, a wellspring of the fanaticism that threw up Osama bin Laden and his furious ilk. Apologists, swayed as often by the ruling Al Sauds' courtly manners as by their fat purses, paint it instead as a repository of noble Arab tradition, a bastion of stability in a strategically crucial but hopelessly troubled region.

So it is a relief to find two accounts with a rare combination of sympathetic nuance and critical rigour. Robert Lacey and Thomas Hegghammer are very different writers. Mr Lacey, an English popular historian, has written a score of books, ranging from a biography of Queen Elizabeth II to a study of Sotheby's, a global auction house. Mr Hegghammer, a Norwegian academic, is a scholar of modern Islamic radicalism. Their latest books on Saudi Arabia differ sharply in style and focus, yet cover the same time frame, share a similar dispassionate objectivity and come to similar conclusions. Both serve as useful correctives to common misreadings of the kingdom and deserve a wide audience.

Mr Lacey has the lighter touch. "The Kingdom", his first book on Saudi Arabia, was written 30 years ago. It traced the history of what then seemed an almost miraculous arc of rags to immense riches. His new work, out last October, focuses, instead, on the three decades since, a much darker period, marked by turbulence and doubt and culminating in an explosion of Islamist violence not just in New York but also in Saudi Arabia itself. Based on hundreds of interviews during a three-year sojourn, the book is less a chronology than a layered sequence of lively and illuminating anecdotes.

Mr Lacey is unsparing about the shortcomings of Saudi rulers, particularly under King Fahd, who died in 2005. In a bid to quash his own reputation as a playboy, the king began by pandering to religious extremists, with disastrous results, and ended his life enfeebled by a series of strokes. Yet Mr Lacey remains sympathetic, quoting a companion of the king as saying that when he died he must surely have gone to heaven, considering that "his life on earth was such hell being perpetually polite to those religious fanatics." Mr Lacey's keen ear picks out enlightening comments from the regime's detractors, too, such as a now-reformed radical describing his youthful dabbling with extremist groups as having felt like a pursuit of boyish fun, where "there was no one who mattered outside your own tight little group."

The author is good at explaining the mechanics of royal rule, with its bouts of harshness followed by conciliation, and its constant, wary punctiliousness regarding religious and tribal rules. In one passage, he describes Prince Salman, the powerful governor of Riyadh, the Saudi capital, personally checking a list of 63 extremists captured after their bloody attempt to seize the great mosque at Mecca in 1979, to make sure that each would be beheaded by, and in front of, members of his own tribe.

Mr Lacey believes that in its slow, crab-like fashion, the kingdom is evolving into a more tolerant society and that, having mostly crushed the internal challenge from violent jihadists, its government is stable. Yet he is equivocal about its long-term prospects: "If, as a country, you adopt the Koran as a constitution, then all your wars must be holy wars, those who die for your country are holy warriors—and the secret police are doing the work of God." In other words, the Al Sauds may have softened somewhat, but they still rely on their subjects' fear of the sword, combined with submission to the faith and giant dollops of cash, to sustain them. That is ▸▸

not, ultimately, a happy formula.

Mr Hegghammer might well agree, though his careful dissection of the motives and methods that gave rise to Saudi jihadism is narrower in its scope. Through the 1980s and early 1990s, conflicts in Afghanistan, Chechnya and Bosnia produced a dovetailing of interests between Western-backed government policy and a home-grown urge for glorious action in the name of Islam. But various factors that converged at the end of the 1990s led to a violent split between those interests. These included a vengeful backlash against the torture of radical dissidents, a vacuum in religious discourse left by the death of a generation of senior Wahhabi clerics, the fanning of Muslim grievances by the internet and satellite television and unfolding events in Iraq and Palestine.

The result was that by August 2001, al-Qaeda's camps in Afghanistan were populated by as many as 1,000 Saudis, with the same number again mobilising and arming at home to rid Arabia of alien influence. Their lunge for power has been bloody and, as Mr Hegghammer shows, disastrously counterproductive. After a wobbly start, the Al Sauds have proven quite resilient, and have become increasingly effective at countering the challenge. In particular, their adoption of a softer approach, combining targeted policing with media campaigns and direct incentives to wean radicals back to the fold, has nearly eliminated, for now, the threat of terrorist action at home. However, the announcement on March 24th that more than 100 suspected militants linked to al-Qaeda had been arrested suggests that the Saudi authorities are still prepared to crack down.

Mr Hegghammer's analysis of the rise and fall of Saudi jihadism reveals some fascinating details. Many Afghan-bound holy warriors were propelled not by animus against the West, but by the trickery of recruiters who promised that this was the road to liberating Jerusalem. Yet what stands out most are his persuasive insights. The spread of jihadist ideas in Saudi Arabia, it seems, owed as much to temporary local factors as to outside influences or, for that matter, to Islamic scripture. The state erred, for instance, with policing methods that switched abruptly from being so hard as to provoke anger to so soft as to dispel fear. Hair-splitting ideological rivalries between Islamists, meanwhile, led to a polarisation of the different camps and to a radicalisation of no more than a few men.

However, the jihadists' overriding focus remained not revolution at home, but action abroad. What this means, says Mr Hegghammer, is that in the global fight against al-Qaeda, "addressing the symbols of Muslim suffering is more urgent than political and economic reform in the Arab world." If only this had been better understood back in September 2001. ■

Jewish philanthropy

Give it all you got

Moses Montefiore: Jewish Liberator, Imperial Hero. By Abigail Green. *Harvard University Press; 540 pages; $35 and £24.95*

IT IS unusual in a long biography for the protagonist to be already in his early 40s and in semi-retirement by page 56. But Moses Montefiore is interesting not so much for the way he grew rich (largely by riding on the coat-tails of his wife's brother-in-law, Nathan Rothschild) but for the career he pursued afterwards. Montefiore was a champion of Jewish rights—the international man of philanthropy of his time—and, as Abigail Green points out, "one of the first truly global celebrities."

Born in 1784 in Leghorn into an Italian Jewish family that had settled in London, Montefiore belonged to Britain's Sephardi elite. They made their fortunes trading coral, diamonds and other commodities across far-flung family and social networks. Montefiore's marriage to Judith Barent-Cohen brought an alliance with the Ashkenazi Rothschilds, who helped him turn a small fortune into a large one. By middle age he was ready to devote himself to his true calling: the rescue of Jews and Judaism from persecution and poverty across much of the globe.

Montefiore was a devout orthodox Jew but no less a Victorian Englishman for that. The queen made him a knight and then a baronet; he was the first sheriff of London, it is said, to bring a kosher chicken to a formal dinner at the Guildhall in the City. He embodied the idea that the Jewish cause was also the cause of humanity in general and of Britain in particular. Montefiore pushed, cautiously, for Jews to win full

Only occasionally did he stray

emancipation. Although this did not come about until late in the 19th century, Britain's political ambitions and its moral aspirations made it possible.

He joined forces with middle-class religious dissenters and evangelicals to help end the slave trade, underwriting along with Rothschild a £15m loan to finance abolition in the West Indies. Idealistic Christians—some of whom were themselves excluded from full civil rights—in turn backed the emancipation of Jews at home and their restoration to the Holy Land. When Montefiore appealed to the Ottoman sultan to protect his Jewish subjects, Lord Palmerston, the British foreign secretary and later prime minister, approved: modernising the crumbling Ottoman empire would help thwart the Middle Eastern ambitions of Russia and France, he thought.

Montefiore was in the thick of all the Jewish *causes célèbres* of his day, sometimes competing for glory with a French rival, Adolphe Crémieux. He braved bandits, cholera and war to succour Jews in the Holy Land. He forded frozen Russian rivers, the ice giving way beneath him, to become the first Jew to meet Tsar Nicholas I. His intercession to defend the Jews of Damascus and Rhodes from blood libel was a triumph: the Ottoman sultan issued an edict denying the libel and guaranteeing Jews protection and freedom of worship. He had less luck with the pope, who refused to return Edgardo Mortara, a Jewish child who had been baptised by his housemaid and kidnapped from his family by the Inquisition. But Ms Green sees in the Mortara affair the embryo of the modern human-rights movement. Treating with potentates in his City of London uniform, Montefiore was lionised by his countrymen for his patriotism and charity; the Jewish attitude verged on veneration.

Ms Green's account is often entertaining but her intent is scholarly. Indeed, she underplays Montefiore's apparent infidelities to Judith, who crossed rivers and mountain passes with him and edited the first kosher cookbook in English. He clearly loved her. His occasional affairs amounted to a betrayal not just of his wife, but also of religious principle, and are passed over too lightly. Ms Green, herself a twig on the Sebag Montefiore family tree, is more interested in historical themes she thinks have been neglected: how Montefiore used piety, philanthropy and publicity to rally sympathy on a global scale, paving the way for today's campaigns and interventions on behalf of humanitarian causes.

Montefiore's century-long life spanned an optimistic age. By its end race-based anti-Semitism was beginning to erupt again and Jews had started to despair even in relatively enlightened western Europe. Alfred Dreyfus, a young Jewish officer in the French artillery, was unjustly convicted of treason just a decade after he died. ■

New American fiction

Give or give up

The Ask. By Sam Lipsyte. *Farrar, Straus and Giraux; 296 pages; $25*

NARRATORS of comic novels tend to fall into two categories. Either they are jaded insiders in a world they see is a sham, or they are hapless outsiders who long to be insiders, even though they sense it is all a sham. Outsiders are harder to pull off. It takes some convincing to empathise with a true loser.

Sam Lipsyte made his name with "Home Land" (2005), a darkly funny book written as letters to an alumni newsletter. The hero was a washout—loveless, nearly friendless and all but jobless ("It's time you knew the cold soft facts of me. I did not pan out."). But he was also hilarious, with the incisive cruelty of a true underdog. Like "Portnoy's Complaint", Philip Roth's 1969 novel, "Home Land" was less a story than a voice, vital, irrepressible and sexually perverted, just without the exploits.

"The Ask", Mr Lipsyte's new novel, is more ambitious. Again the narrator, Milo Burke, is a sad, cynical sack. Raised in the New Jersey suburbs and trained as a painter, he once believed that his artistic genius would make him famous. Now in his 40s, with the slovenly build of a "half-melted block of Muenster cheese", he is embittered, occasionally mawkish and complacent; a "man with many privileges and zero skills. What used to be called an American."

But Milo makes do. He bumbles through his job fund-raising for an art school, and spends his nights watching television with his wife and son. His life is as reassuringly bland as his daily turkey-wrap lunch. But then he is sacked from his job and exiled to the unemployed wilds of doughnut shops and internet porn. His luck seems to change when a rich old college buddy involves him in an important potential donation to the school. Milo's challenge is to secure the funding (the titular "ask") without getting tied up in all the strings attached.

Like "Home Land", this is a brutally witty novel told from the perspective of a pitiable misfit. "For heaven's sake," Milo's mother marvels, "the system's rigged for white men and you still can't tap in." Though he fails to make sense of his own life, Milo's observations of the world around him (academia, semi-suburbia, his marriage, his son, his own hands—like "lovingly shaved gerbils") glisten with insight and humour.

Despite its class-clown antics, "The Ask" is darker and more humane than the

author's earlier work. Milo may be a disaster, but he is drawn with tenderness. Mr Lipsyte has written a surprisingly meaningful book about the freshly minted grown-ups of his own generation (he was born in 1968), raised on dreams and sitcoms, who now find themselves in cubicles, growing chubby, having children, and wondering what life is meant to feel like. ■

William Shakespeare

Hero or hoax

Contested Will: Who Wrote Shakespeare? By James Shapiro. *Simon & Schuster; 367 pages; $26. Faber and Faber; £20*

JAMES SHAPIRO follows his award-winning book on William Shakespeare, "1599", which came out in 2005, with an unlikely subject: an investigation into the old chestnut that Shakespeare wasn't the man who wrote the works.

Most mainstream Shakespeareans stand aloof from it. But apparently the claims of Francis Bacon, Edward de Vere and Christopher Marlowe, among others, are on the rise. An appetite for conspiracy theories, combined with a call for "balance" from some sectors of academe and the rise of the internet have given the thing new life. Respectable audiences turn up to listen to lectures on it. The controversy is even taught at university level. "What difference does it make who wrote the plays?" someone asked the author wearily. Mr Shapiro (for whom Shakespeare was definitely the man) thinks it matters a lot, and by the end of this book, his readers will think so too.

The authorship controversy turns on two things: snobbery and the assumption that, in a literal way, you are what you write. How could an untutored, untravelled glover's son from hickville, the argument goes, understand kings and courtiers, affairs of state, philosophy, law, music—let alone the noble art of falconry? Worse still, how could the business-minded, property-owning, moneylending materialist that emerges from the documentary scraps, be the same man as the poet of the plays? Many have shaken their heads at the sheer vulgarity of it all, among them Mark Twain, Helen Keller, Henry James, his brother William, and Sigmund Freud.

Mr Shapiro teases out the cultural prejudices, the historical blind spots, and above all the anachronism inherent in these questions. No one before the late 18th century had ever asked them, or thought to read the plays or sonnets for biographical insights. No one had even bothered to work out a chronology for them. The idea that works of literature hold personal clues, or that—more grandly—writing is an expression and exploration of the self, is a relatively recent phenomenon.

The central chapters of Mr Shapiro's book concentrate on the 19th and early 20th centuries, when the search for alternative claimants took off. The two main characters in his story are Delia Bacon, who in 1857 put forward a Renaissance philosopher Francis Bacon (no relation); and J.T. Looney, who in 1920 proposed an Elizabethan courtier, Edward de Vere, 17th Earl of Oxford. Mr Shapiro takes them both seriously, patiently following their lives and contextualising their ideas. It is no accident that by the time Delia Bacon entered the field, Shakespeare had become almost a god in the public imagination. Both she and Looney developed their theories in a spirit of religious doubt, and in the throes of their own personal crises.

"Contested Will" is dense with lives and stories and argument. It is also entertaining. The quest for the true claimant drove people mad. Here are secrets and codes, an elaborate cipher-breaking mach- ▸▸

Where there's a Will

ine, an obsession with graves and crazy adventures to find lost manuscripts. One man spent months dredging the River Severn. Mr Shapiro himself turns sleuth, exposing as fraudulent a piece of evidence long thought to be genuine—one more hoax in the long history of Shakespearean wild goose chases.

The last chapter is a return to sanity: a brilliant defence of the man from Stratford. Piece by piece, Mr Shapiro builds the case—the contemporary witnesses, the tracks left by printing houses and theatrical practice, the thousand details that show, apart from anything else, how unnecessary the whole farrago has been. The Shakespeare that emerges is both simple and mysterious: a man of the theatre, who read, observed, listened and remembered. Beyond that is imagination. In essence, that's what the book is about. ■

Kinshasa Symphony Orchestra

An ode to joy

The enduring power of classical music

ARMAND DIANGIENDA does not have an easy time as a conductor. When he started out, his many violinists took turns playing the five instruments in 20-minute shifts. When the strings broke, they were replaced with brake cables from old bicycles. Once he was forced to fashion a bell from the wheel of a bus.

But he remains undeterred. "Kinshasa Symphony", a documentary by Claus Wischmann and Martin Baer, follows Mr Diangienda and the Orchestre Symphonique Kimbanguiste in Kinshasa as they prepare for a concert of Beethoven's ninth symphony. The players are all amateurs who squeeze their music-making into already crammed lives.

Joseph Masunda, a viola player, is also an electrician and hairdresser. When power cuts plunge rehearsals into darkness, he downs his instrument and snatches up his tools. He is not alone in his devotion to classical music. Albert Matubanza, the orchestra manager, dismantles his double bass to pore over its innards before setting to work on building more to replenish the orchestra's store of instruments.

That they are playing in Congo, a country riven by war, is impossible to forget. There are hints of the horrors beyond. They have few instruments because they were stolen during the fighting. Nathalie Bahati (pictured right), a flautist who teeters elegantly on impractical cream heels, lost her father in the fighting.

But the film treats Congo's tragedy with a light touch. Rather, most of the orchestra's problems will be familiar to amateur musicians the world over. Mr Diangienda berates his choir for failing to practise the difficult bits of the symphony, warning them sternly that they will not perform if they are not up to scratch. Trésor Wamba, a tenor, struggles to persuade his teenage friends that the concert won't send them to sleep. Mireille Kinkina, another singer, battles for control of the bedroom where she wants to practise but where her sister wants to relax and watch television.

A scene of Mr Masunda playing his viola at a busy interchange in the swirling Kinshasa dust is a touch contrived. But the verve with which he attacks the music is not. His intonation may be off but his joy, and that of the other players, as they scrape and saw and toot and hoot amid the traffic, is unmistakable. For each, performing is a moment of escape. The music takes you far away, to another world, smiles Ms Kinkina. In Congo it is easy to see why that would appeal.

Daughter of Elysium

The rise and fall of Carthage

Rival to Rome

Carthage Must Be Destroyed: The Rise and Fall of an Ancient Civilisation. By Richard Miles. *Allen Lane; 521 pages; £30*

IT IS ironic that the most famous event in the history of Carthage is a land journey, for the Carthaginians were fundamentally a seafaring nation. Their fleets dominated the Mediterranean and they grew rich through trade and the establishment of colonies in Sicily, Sardinia and Cyprus. There was abundant cause, though, for Hannibal, a Carthaginian general, to take the land route across the Pyrenees and Alps to Rome in the winter of 218BC. Hannibal had long been campaigning in Spain and invading from the north added an element of surprise. But the principal reason for not making the short sea crossing from Africa to Italy was that by then the Romans had replaced the Carthaginians as the masters of the Mediterranean.

Before the Carthaginians came the Phoenicians, the great merchants from Tyre in modern Lebanon. To satisfy the appetite of the Assyrians they created the silver routes and established a number of cities such as Gades (Cadiz). Their greatest legacy, though, was a colony in what is now Tunisia. Its renown would soon come to outshine that of its parent.

Carthage would itself be eclipsed by Rome but, as Richard Miles recounts, its existence and the rivalry it provided were essential to the growth of Rome and the way in which it sought to project its image. From the beginning, myth and history were intertwined. In the "Aeneid" Virgil describes the doomed love affair between Dido, Queen of Carthage, and Aeneas, the son of Venus and legendary forefather of the Romans, who on his journey from Troy to Italy has been washed up on the shores of her city. Ironically, the way in which Aeneas abandons Dido in favour of his preordained fate is characteristic of Carthaginian treachery.

Virgil was aware of the value of myth in establishing the divine antecedents of Augustus's expanding empire. And he was not alone in employing it to emphasise the interlocking fortunes of the two nations. Earlier writers had claimed that Rome and Carthage were founded in the same year, 753BC. In order to establish their credentials within the Hellenic world the Carthaginians conflated the Greek hero, Heracles (better known as Hercules), with Melqart, his Tyrian counterpart. Hannibal, a master of propaganda eager to create a reputation to equal that of Alexander the Great, followed the Herculean route to Italy. The Romans were severely tested in the three Punic wars but their struggles against a worthy, if barbaric and perfidious, enemy were a necessary feature of their emergence as the dominant power.

Hannibal was a heroic figure and a superb tactician. But he was ultimately overcome by Scipio Africanus, an equally brilliant commander, who learned much of tactics and propaganda from his opponent and whose nation possessed a unique determination and resilience. Mr Miles has skilfully fused the works of ancient historians such as Polybius and Livy, a wide range of modern studies and recent archaeological research to create a convincing and enthralling narrative. ■

Doris Haddock

Doris "Granny D" Haddock, campaigner for election reform, died on March 9th, aged 100

THE most trying part came in the Mojave desert of California. The royal blue sky glared down on the grey brittlebush, and the heat was searing. Great trucks thundered past, showering her with grit, and a fierce wind got up that made her stagger. The worst of it was that her hat (the straw garden hat that had belonged to her dear friend Elizabeth) was whipped off and trundled through the cacti, where it splintered and broke.

She was walking across America, an odd occupation for a woman of 89. But Doris Haddock became annoyed if anyone made much of that. Her large, dark eyes narrowed then, and her gentle voice acquired an edge. And indeed there was little in that voice, with its perfectly enunciated consonants (drilled into her at Emerson College of Oratory, when she had girlish dreams of going on the stage) to suggest she was much over 30. The adventurer in her heart, she liked to say—stressing that she meant the adventurer in everyone's heart—was always young. She could still ski, hump a 25-pound pack, sleep on the ground and get up again; and though she went to bed choking on dust in Arizona, or nursing bleeding feet from frozen shoes in West Virginia, the next day she made sure she walked her set ten miles, until all 3,200 had been done. Friends in Louisville made a stout oak staff for her; she slung it over her shoulder, and hung her banner from it.

The question she wanted people to ask was not how (on earth!), but why. Why, in January 1999, had she set off to walk from Pasadena to Washington, DC? The simple answer was that she had lost patience with the power of big money in American politics. Congressmen and senators did not listen to people like her—people who spent years nursing their husbands when they had Alzheimer's, or who battled to keep the interstate out of their small towns, in her case Dublin, New Hampshire. They patted little old ladies like her patronisingly on the head, while taking wads of money from special interests for whom they would do favours later. Mrs Haddock was sick of it. She had organised petitions for campaign-finance reform, with tens of thousands of signatures, but got nowhere. So it was sneakers on, and hit the road.

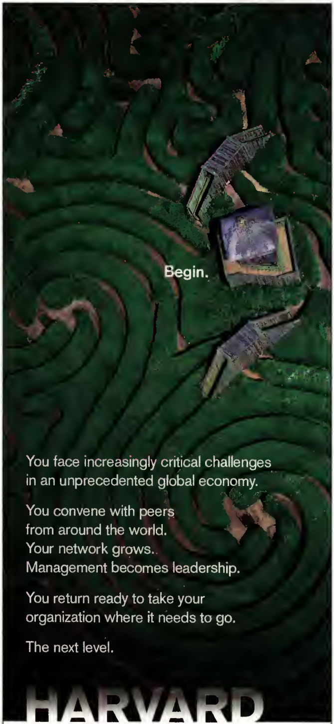
She also had more complex reasons which, with her usual candour, she didn't hide. Six years after her Jim's death she had entered a "dry and blank space" where she seemed to need to do something, but couldn't tell what. She had always hiked the mountains as a respite from order forms and insoles at the Bee Bee shoe company in Manchester, where she worked for 20 years and became the manager's assistant. And once in 1960 (though she found politics a "total bore" in those days) she and Jim had taken the Volkswagen as far as Alaska to protest against hydrogen-bomb testing near an Inuit village. Almost 40 years later, oddly enough, as she was being driven through Florida by her son, also Jim, she spotted in the wilderness, miles from anywhere, an old man in a mackintosh holding a paper bag and walking with a cane. He seemed, to her, some ghost or remnant of her protest days, calling to her to get walking.

Hat and feather

Her trudge was not just a lone yell for honesty and equality in politics, though that was the burden of the bright yellow banner flying over her bent back. She also treated it as a meditation, a way to represent love in the world in the style of Gandhi or Martin Luther King, from whose pulpit in Little Rock she preached when she got there. Her notion was to walk as a pilgrim, fasting until she was given food and not resting until she found shelter. She never had to worry on either score. She was taken in all along the route, serenaded on street corners, welcomed by marching bands and protected on the highways by squads of hefty bikers. Nature was her only opponent, choking with reeds her path to the Pecos river, sending down blizzards that forced her to take to skis in the Appalachians, and playing up her arthritis—though she made nothing of that.

Boldly in February 2000 she marched into Washington and up the Capitol steps, announcing that she was going to sweep the scoundrels away as thoroughly as leaves from her porch. The scoundrels stayed, shameless as ever. The election that November proved the most costly to date. In advance of the next one Mrs Haddock—now universally known as "Granny D", for Doris, with her straw hat brightly banded and stuck with a turkey feather—tried a new tack of driving in a gaudy bus through swing states, persuading women to register to vote. She was then 93; she covered 22,000 miles. The next year she ran against Judd Gregg, pretty creditably, on small donations only, for the Senate.

Public funding of campaigns, her great hope, got no closer. And even McCain-Feingold, the most solid reform of recent years, passed not long after her triumphant walk, was gutted by the Supreme Court in January this year. The ruling came just before Mrs Haddock's 100th birthday, when anyone else might have been content to sit smiling beside the cake. But she was busy drafting a letter to the nine "bastards", threatening to go in "breathtaking new directions" to defend democracy, and casting more than one longing thought towards the sneakers in her closet, and the desert's mischievous wind. ■



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Announcements

Economic and financial indicators

Overview

In **America** sales of new homes fell by 2.2% during the month of February to an annual pace of 308,000, the slowest since records began in 1963. Severe weather may be partly to blame: sales fell most in the parts of the country where there were unusually severe snowstorms last month.

America's current-account deficit rose to $115.6 billion in the final quarter of 2009 from $102.3 billion in the previous quarter.

Inflation in **Britain** fell to 3% in February from 3.5% in January. Prices rose by 0.4% during the month of February.

The closely watched Ifo index of **German** business confidence increased in March to 98.1, its highest level since June 2008, from 95.2 in February.

Industrial orders in the **euro area** fell by 2% in January after rising by 0.8% during the month of December.

In **Hong Kong** prices increased by 2.8% in the year to February. January's inflation rate was 1%.

In **Malaysia** prices did not change between January and February. The annual rate of inflation dipped slightly to 1.2% last month from 1.3% in January.

Industrial production in **Taiwan** rose by 35.2% in the year to the end of February.

Argentina's GDP grew by 2.6% in the year to the last quarter of 2009.

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% change on year ago

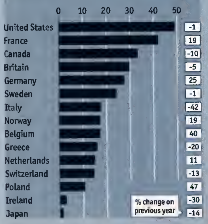
	Gross domestic product				Industrial production	Consumer prices			Unemployment
	latest	qtr*	2010†	2011†	latest	latest	year ago	2010†	rate‡, %
United States	+0.1 Q4	+5.9	+3.1	+2.9	+1.7 Feb	+2.1 Feb	+0.2	+2.2	9.7 Feb
Japan	−1.0 Q4	+3.8	+1.7	+1.6	+18.5 Jan	−1.3 Jan	nil	−0.9	4.9 Jan
China	+10.7 Q4	na	+9.6	+8.1	+12.8 Feb	+2.7 Feb	−1.6	+3.5	9.6 2009
Britain	−3.3 Q4	+1.1	+1.3	+2.1	−1.5 Jan	+3.0 Feb§	+3.2	+2.7	7.8 Jan††
Canada	−1.2 Q4	+5.0	+2.7	+3.0	−5.0 Dec	+1.6 Feb	+1.4	+1.5	8.2 Feb
Euro area	−2.1 Q4	+0.5	+1.2	+1.4	+1.4 Jan	+0.9 Feb	+1.2	+1.2	9.9 Jan
Austria	−1.9 Q4	+1.4	+1.3	+1.4	−4.6 Dec	+0.9 Feb	+1.6	+1.2	5.3 Jan
Belgium	−0.8 Q4	+1.2	+1.4	+1.5	−5.3 Dec	+0.7 Feb	+1.9	+1.2	12.1 Feb‡‡
France	−0.3 Q4	+2.4	+1.6	+1.6	+3.5 Jan	+1.3 Feb	+0.9	+1.3	10.1 Jan
Germany	−2.4 Q4	nil	+1.6	+1.5	+2.1 Jan	+0.6 Feb	+1.0	+0.9	8.2 Feb
Greece	−2.5 Q4	−3.1	−2.5	−0.7	−3.1 Jan	+2.8 Feb	+1.6	+1.5	10.2 Dec
Italy	−3.0 Q4	−1.2	+0.9	+1.2	+0.1 Jan	+1.1 Feb	+1.6	+1.4	8.3 Q4
Netherlands	−2.2 Q4	+0.9	+1.2	+1.5	+5.3 Jan	+0.8 Feb	+2.0	+0.9	5.7 Feb††
Spain	−3.1 Q4	−0.6	−0.3	+1.0	−4.6 Jan	+0.8 Feb	+0.7	+1.4	18.8 Jan
Czech Republic	−3.1 Q4	+3.0	+0.9	+2.8	+5.3 Jan	+0.6 Feb	+2.0	+1.6	9.9 Feb
Denmark	−3.4 Q4	+0.9	+1.3	+1.8	−10.4 Jan	+1.9 Feb	+1.9	+1.5	4.2 Jan
Hungary	−4.0 Q4	−1.7	−0.7	+2.8	+5.7 Jan	+5.7 Feb	+3.0	+4.0	10.8 Jan††
Norway	−1.2 Q4	+0.4	+1.6	+1.8	−3.1 Jan	+3.0 Feb	+2.5	+2.0	3.3 Jan§§
Poland	+3.1 Q4	na	+2.5	+3.0	+9.2 Feb	+2.9 Feb	+3.3	+2.8	13.0 Feb‡‡
Russia	−8.9 Q3	na	+3.5	+4.3	+1.9 Feb	+7.2 Feb	+13.9	+7.0	8.6 Feb‡‡
Sweden	−1.5 Q4	−2.2	+2.2	+2.4	−0.2 Jan	+1.2 Feb	+0.9	+1.2	9.3 Feb‡‡
Switzerland	+0.6 Q4	+3.0	+1.3	+1.6	−1.1 Q4	+0.9 Feb	+0.2	+0.7	4.1 Feb
Turkey	−3.3 Q3	na	+3.6	+3.8	+12.1 Jan	+10.1 Feb	+7.7	+10.2	13.5 Dec‡‡
Australia	+2.7 Q4	+3.7	+2.9	+3.4	−3.8 Q3	+2.1 Q4	+3.7	+2.4	5.3 Feb
Hong Kong	+2.6 Q4	+9.5	+4.7	+3.6	−4.9 Q4	+2.8 Feb	+0.8	+2.0	4.6 Feb††
India	+6.0 Q4	na	+7.7	+8.0	+16.7 Jan	+16.1 Jan	+10.5	+10.7	10.7 2009
Indonesia	+5.4 Q4	na	+5.6	+5.9	+5.7 Jan	+3.8 Feb	+8.6	+5.8	8.1 Feb
Malaysia	+4.5 Q4	na	+5.4	+4.0	+12.7 Jan	+1.2 Feb	+3.7	+1.7	3.6 Q3
Pakistan	+2.0 2009**	na	+2.8	+4.2	+7.5 Jan	+13.0 Feb	+21.1	+11.4	5.2 2008
Singapore	+3.5 Q4	−6.8	+5.1	+5.0	+39.4 Jan	+1.0 Feb	+3.3	+2.2	2.1 Q4
South Korea	+6.0 Q4	+0.7	+5.1	+4.0	+36.9 Jan	+2.7 Feb	+4.1	+2.9	4.4 Feb
Taiwan	+9.2 Q4	na	+4.9	+4.6	+35.2 Feb	+2.4 Feb	−1.3	+1.6	5.7 Feb
Thailand	+5.8 Q4	+15.3	+3.8	+4.4	+28.6 Jan	+3.7 Feb	−0.1	+3.3	0.9 Dec
Argentina	+2.6 Q4	+7.9	+3.1	+2.6	+8.2 Jan	+9.1 Feb***	+6.8	+10.2	8.4 Q4‡‡
Brazil	+4.3 Q4	+8.4	+5.0	+4.5	+16.0 Jan	+4.8 Feb	+5.9	+4.8	7.2 Jan‡‡
Chile	+2.1 Q4	+5.9	+5.2	+4.5	−1.1 Jan	+0.3 Feb	+5.5	+1.7	8.7 Jan††‡‡
Colombia	−0.2 Q3	+0.9	+2.5	+3.4	+1.6 Jan	+2.1 Feb	+6.5	+2.5	14.6 Jan‡‡
Mexico	−2.3 Q4	+8.4	+3.4	+2.8	+3.6 Jan	+4.8 Feb	+6.2	+5.6	5.9 Jan‡‡
Venezuela	−5.8 Q4	na	−5.6	−1.2	−11.6 Dec	+27.0 Feb	+29.5	+29.7	7.4 Q4‡‡
Egypt	+4.9 Q3	na	+5.5	+5.6	+6.7 Q3	+12.8 Feb	+13.5	+10.1	9.4 Q4‡‡
Israel	+1.9 Q4	+4.4	+3.2	+3.5	+4.5 Jan	+3.6 Feb	+3.3	+2.0	7.4 Q4
Saudi Arabia	+4.4 2008	na	+3.3	+3.5	na	+4.6 Feb	+6.9	+3.5	na
South Africa	−1.4 Q4	+3.2	+2.8	+3.7	+3.7 Jan	+5.7 Feb	+8.6	+5.9	24.3 Dec‡‡

*% change on previous quarter, annual rate. †*The Economist* poll or Economist Intelligence Unit estimate/forecast. ‡National definitions. §RPI inflation rate 3.7 in January. **Year ending June. ††Latest 3 months. ‡‡Not seasonally adjusted. §§Centred 3-month average. ***Unofficial estimates are higher.

Asylum-seekers

The UN High Commissioner for Refugees reckons that 377,160 people sought asylum in industrialised countries last year, almost exactly the same number as in 2008. The number of asylum-seekers rose in 19 countries and fell in another 25. The fall was sharpest in southern Europe, where almost a third fewer people sought refuge last year than in 2008. America remained the most favoured destination, receiving 49,020 applications in 2009. The number of people seeking refuge in Nordic countries rose by 13%. More asylum-seekers came from Iraq than from any other country during 2008. But last year Iraqis were outnumbered by Afghans, 26,800 of whom sought asylum in rich countries, 45% more than during 2008.

Asylum applications submitted*, 2009, '000



Source: UNHCR *Selected countries

The Economist commodity-price index

2000=100

	Mar 16th	Mar 23rd*	% change on one month	% change on one year
Dollar index				
All items	210.6	211.7	−0.0	+31.0
Food	196.3	196.9	−2.8	+4.3
Industrials				
All	229.0	230.9	+3.2	+82.5
Nfa†	200.6	203.6	+2.9	+83.7
Metals	244.5	245.7	+3.3	+81.9
Sterling index				
All items	210.2	213.1	+2.5	+28.0
Euro index				
All items	141.5	144.7	+0.3	+30.9
Gold				
$ per oz	1125.00	1102.60	−0.2	+19.4
West Texas Intermediate				
$ per barrel	81.79	81.62	+3.7	+52.4

*Provisional †Non-food agriculturals.

Trade, exchange rates, budget balances and interest rates

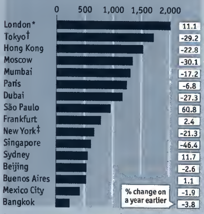
	Trade balance* latest 12 months, $bn	Current-account balance latest 12 months, $bn	Current-account balance % of GDP 2010†	Currency units, per $ Mar 24th	Currency units, per $ year ago	Budget balance % of GDP 2010†	Interest rates, % 3-month latest	Interest rates, % 10-year gov't bonds, latest
United States	-518.8 Jan	-419.9 Q4	-3.2	-	-	-11.1	0.22	3.82
Japan	+55.1 Jan	+152.9 Jan	+2.8	91.9	97.7	-7.8	0.29	1.31
China	+175.8 Feb	+284.4 Q4	+5.0	6.83	6.83	-3.3	1.94	3.29
Britain	-129.9 Jan	-28.2 Q3	-1.1	0.67	0.69	-13.5	0.65	4.00
Canada	-2.5 Jan	-36.6 Q4	-2.3	1.03	1.22	-3.6	0.24	3.66
Euro area	+35.5 Jan	-67.6 Jan	-0.4	0.75	0.74	-7.2	0.64	3.07
Austria	-5.0 Dec	+7.5 Q3	+1.3	0.75	0.74	-5.0	0.64	3.46
Belgium	+18.2 Dec	-3.2 Sep	+0.4	0.75	0.74	-6.6	0.64	3.57
France	-59.5 Jan	-51.5 Jan	-1.8	0.75	0.74	-8.6	0.64	3.40
Germany	+193.1 Jan	+169.0 Jan	+5.2	0.75	0.74	-5.6	0.64	3.07
Greece	-42.8 Dec	-38.0 Jan	-8.6	0.75	0.74	-9.5	0.64	6.24
Italy	-5.6 Jan	-66.3 Jan	-2.5	0.75	0.74	-5.0	0.64	3.91
Netherlands	+47.0 Jan	+34.8 Q3	+4.9	0.75	0.74	-6.2	0.64	3.33
Spain	-69.9 Dec	-73.2 Dec	-4.5	0.75	0.74	-11.6	0.64	3.82
Czech Republic	+8.6 Jan	-1.4 Jan	-2.2	19.0	20.2	-5.2	1.44	4.07
Denmark	+12.8 Jan	+13.0 Jan	+2.5	5.57	5.50	-5.8	1.35	3.36
Hungary	+6.3 Jan	-2.1 Q3	-2.3	198	221	-4.0	5.69	6.97
Norway	+54.3 Feb	+53.5 Q4	+14.8	6.03	6.51	9.3	2.30	3.75
Poland	-4.4 Jan	-7.2 Jan	-2.8	2.91	3.35	-2.8	4.12	5.51
Russia	+120.8 Jan	+47.5 Q4	+4.2	29.7	33.6	-4.0	8.50	6.29
Sweden	+11.4 Jan	+29.2 Q4	+7.1	7.27	8.07	-3.0	0.19	3.15
Switzerland	+19.9 Feb	+42.4 Q3	+7.7	1.07	1.12	-1.3	0.25	1.78
Turkey	-40.9 Jan	-16.3 Jan	-3.8	1.54	1.66	-5.2	7.37	7.00‡
Australia	-8.2 Jan	-42.4 Q4	-4.0	1.10	1.43	-3.1	4.36	5.69
Hong Kong	-33.1 Feb	+18.4 Q4	+8.0	7.76	7.75	-0.2	0.14	2.49
India	-83.8 Jan	-31.5 Q3	-1.0	45.6	50.8	-6.4	4.42	8.19
Indonesia	+21.2 Jan	+10.6 Q4	+1.5	9,120	11,530	-2.1	7.09	5.23‡
Malaysia	+35.2 Jan	+32.0 Q4	+13.0	3.32	3.63	-5.8	2.48	1.55‡
Pakistan	-14.7 Feb	-3.4 Q4	-2.3	84.1	80.6	-5.5	12.36	8.94‡
Singapore	+26.5 Feb	+34.0 Q4	+12.3	1.41	1.51	-2.7	0.50	2.61
South Korea	+43.3 Feb	+43.8 Jan	+3.5	1,138	1,362	-4.1	2.80	4.82
Taiwan	+17.8 Feb	+42.6 Q4	+8.4	31.8	33.9	-3.8	0.91	1.22
Thailand	+18.3 Jan	+19.9 Jan	+4.2	32.4	35.5	-3.7	1.42	3.29
Argentina	+16.6 Feb	+11.3 Q4	+2.4	3.87	3.68	-1.5	12.00	na
Brazil	+24.3 Feb	-28.1 Feb	-2.8	1.79	2.24	-3.0	8.65	6.16‡
Chile	+15.3 Feb	+4.2 Q4	+2.0	534	574	-0.7	0.60	2.29‡
Colombia	+1.7 Dec	-6.1 Q3	-1.8	1,922	2,377	-3.8	3.84	4.98‡
Mexico	-2.7 Feb	-5.2 Q4	-1.6	12.5	14.2	-1.6	4.46	7.58
Venezuela	+19.2 Q4	+8.6 Q4	+5.6	6.88§	5.94§	-3.0	14.54	6.55‡
Egypt	-25.4 Q3	-4.9 Q3	-0.8	5.50	5.63	-9.4	9.68	1.69‡
Israel	-5.4 Feb	+7.2 Q4	+3.1	3.75	4.17	-4.3	1.47	3.69
Saudi Arabia	+212.0 2008	+134.0 2008	+11.5	3.75	3.75	1.7	0.72	na
South Africa	-0.5 Jan	-11.4 Q4	-5.4	7.37	9.44	-6.6	7.08	8.71

*Merchandise trade only. †*The Economist* poll or Economist Intelligence Unit estimate. ‡Dollar-denominated bonds. §Unofficial exchange rate.

Office rents

London is the world's most expensive city in which to rent and operate office space, according to CB Richard Ellis, a property consultancy. "West End" rents have increased by 11% in dollar terms over the past 12 months, although that increase is mainly down to the appreciation of sterling against the dollar. Office rents in São Paulo have increased by 61%, partly due to newly built office space coming to market, but for the most part caused by the depreciation of the dollar against the real by 35%. In Tokyo, the most expensive city twelve months ago, rents have fallen by nearly 30%. They have also fallen by more than a quarter in Dubai, which three months ago opened the world's tallest building, the Burj Khalifa.

Total annual rent, taxes and operating expenses
Q4 2009, $ per sq metre



Source: CB Richard Ellis *West End †Inner Central ‡Downtown

Markets

	Index Mar 24th	% change on one week	% change on Dec 31st 2009 in local currency	% change on Dec 31st 2009 in $ terms
United States (DJIA)	10,836.2	+1.0	+3.9	+3.9
United States (S&P 500)	1,167.7	+0.1	+4.7	+4.7
United States (NAScomp)	2,398.8	+0.4	+5.7	+5.7
Japan (Nikkei 225)	10,815.0	-0.3	+2.5	+3.9
Japan (Topix)	952.0	+0.5	+4.9	+6.3
China (SSEA)	3,205.2	+0.2	-6.8	-6.8
China (SSEB, $ terms)	254.5	+0.8	+0.8	+0.8
Britain (FTSE 100)	5,677.9	+0.6	+4.9	-3.1
Canada (S&P TSX)	11,963.0	-1.1	+1.8	+4.0
Euro area (FTSE Euro 100)	904.2	-0.7	-1.2	-6.8
Euro area (DJ STOXX 50)	2,903.9	-0.9	-2.1	-7.6
Austria (ATX)	2,584.8	-0.9	+3.6	-2.3
Belgium (Bel 20)	2,649.7	-0.6	+5.5	-0.5
France (CAC 40)	3,949.8	-0.2	+0.3	-5.4
Germany (DAX)*	6,039.0	+0.2	+1.4	-4.4
Greece (Athex Comp)	2,062.9	-1.3	-6.1	-11.4
Italy (FTSE/MIB)	22,798.7	-0.5	-1.9	-7.5
Netherlands (AEX)	341.7	-0.4	+1.9	-3.9
Spain (Madrid SE)	1,123.1	-2.8	-9.6	-14.7
Czech Republic (PX)	1,183.9	-2.8	+6.0	+2.6
Denmark (OMXCB)	361.5	+2.1	+14.5	+6.5
Hungary (BUX)	24,442.4	+2.8	+15.1	+9.7
Norway (OSEAX)	421.7	+0.7	+0.4	-3.8
Poland (WIG)	41,790.3	-0.4	+4.5	+2.6
Russia (RTS, $ terms)	1,514.6	-3.1	+2.6	+4.8
Sweden (OMXS30)	1,027.1	+0.1	+7.9	+6.1
Switzerland (SMI)	6,880.0	-0.2	+5.1	+1.6
Turkey (ISE)	55,136.6	+1.5	+4.4	+1.3
Australia (All Ord.)	4,903.2	+0.7	+0.4	+2.8
Hong Kong (Hang Seng)	21,008.6	-1.8	-3.9	-4.0
India (BSE)	17,451.0	-0.2	-0.1	+2.0
Indonesia (JSX)	2,774.9	+0.7	+9.5	+12.8
Malaysia (KLSE)	1,309.5	+0.6	+2.9	+6.2
Pakistan (KSE)	10,146.3	+1.7	+8.1	+8.4
Singapore (STI)	2,886.4	-1.1	-0.4	-0.5
South Korea (KOSPI)	1,681.0	-0.1	-0.1	+2.2
Taiwan (TWI)	7,822.7	-0.3	-4.5	-3.9
Thailand (SET)	786.5	+2.7	+7.1	+10.2
Argentina (MERV)	2,439.3	+2.4	+5.1	+3.3
Brazil (BVSP)	68,913.0	-1.2	+0.5	-2.1
Chile (IGPA)	17,666.7	-0.5	+6.2	+1.0
Colombia (IGBC)	11,978.0	-0.6	+3.2	+9.7
Mexico (IPC)	33,161.0	+1.1	+3.2	+7.5
Venezuela (IBC)	57,211.2	+0.9	+3.9	+11.8
Egypt (Case 30)	6,716.8	+2.4	+8.2	+7.8
Israel (TA-100)	1,160.2	+0.3	+8.9	+10.0
Saudi Arabia (Tadawul)	6,757.0	+1.2	+10.4	+10.4
South Africa (JSE AS)	28,401.7	-0.5	+2.7	+2.6
Europe (FTSEurofirst 300)	1,072.5	+0.2	+2.6	-3.3
World, dev'd (MSCI)	1,190.3	-1.0	+1.9	+1.9
Emerging markets (MSCI)	992.0	-1.4	+0.3	+0.3
World, all (MSCI)	304.4	-1.1	+1.7	+1.7
World bonds (Citigroup)	818.1	-1.8	-1.5	-1.5
EMBI+ (JPMorgan)	510.9	-0.4	+3.6	+3.6
Hedge funds (HFRX)†	1,172.2	+0.2	+1.3	+1.3
Volatility, US (VIX)	17.6	16.9	21.7	(levels)
CDSs, Eur (iTRAXX)‡	71.8	+0.7	+2.6	-3.3
CDSs, N Am (CDX)‡	99.8	-3.7	-8.2	-8.2
Carbon trading (EU ETS) €	12.7	-2.5	+0.3	-5.4

*Total return index. †Mar 23rd. ‡Credit-default-swap spreads, basis points. Sources: National statistics offices, central banks and stock exchanges; Thomson Reuters; WM/Reuters; JPMorgan Chase; Bank Leumi le-Israel; CBOE; CMIE; Danske Bank; EEX; HKMA; Markit; Standard Bank Group; UBS; Westpac

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